A. Proper Treatment of Transportation Transactions

Introduction

The supply of gas to Ontario is an increasingly complex challenge for utilities and shippers. Historically, supply sources have been remote from Ontario and secure supply was built upon long-term, long-haul contracts that were seasonally balanced by storage in southwestern Ontario. From a customer perspective, this challenge was handled by the utilities and there was little concern over the mechanics because the costs were understood to be a pass-through.

In 2012, this assumption was tested in the parallel proceedings EB-2011-0210 and EB-2012-0087. The decision on the preliminary issue in EB-2012-0087 (the "Preliminary Decision") determined that the benefits of using the attributes of Firm Transport ("FT") contracts through the Risk Alleviation Mechanism ("RAM") program were to be treated as reductions in cost of gas with the utility receiving an incentive for the creating the transaction[1]. Further, the Board approved a reduction of gross margin with an allocation to fuel and UDC costs[2]. However, it was determined that the use of FT-RAM credits generated from FT contracts were not traditional transactional services.[3]

In the current proceeding, Union has applied to the Board to revert to the treatment of the benefits of FT-RAM transactions as transactional services with the margin flowing to profits subject to the earnings sharing calculation for sharing with ratepayers. In our submission, this proposition should be rejected in favour of treatment consistent with the EB-2012-0087 decision for the following reasons:

1. Upstream Transport of Gas to Ontario is a Gas Cost and a Pass-Through

Upstream transport costs have historically been treated as a pass-through. This fact was noted in the Preliminary Decision. More specifically, the Preliminary Decision noted the specific

[1] EB-2012-0087 Decision on the Preliminary Issue dated Nov. 19, 2012
[2] EB-2012-0087 Decision dated Feb. 5, 2013
[3] EB-2012-0087 Decision on the Preliminary Issue dated Nov. 19, 2012, page 27.

inclusion of upstream transportation costs in the Settlement Agreement.[4] Further and very directly to this issue, the findings articulated:

> ***The Board agrees with the submissions of parties that the utilization of TCPL's FT-RAM program by Union allows Union to manage its upstream transportation arrangements on a planned basis by leaving pipe empty and flowing gas on a different and cheaper path. The Board finds that the effect of this activity is that higher upstream transportation costs that are paid for by Union's customers, have been substituted with lower cost upstream transportation arrangements.***
>
> ***The Board finds that Union has used TCPL's FT-RAM program to create a profit from the upstream transportation portfolio and has treated this profit as utility earnings, subject only to the provisions of the earnings sharing mechanism.***
>
> ***The Board finds that this treatment is inconsistent with the Settlement Agreement on the IRM Framework and contrary to long standing regulatory principle inherent in the IRM Framework that the cost of gas and upstream transportation are to be treated as pass- through items, and therefore that Union cannot profit from the procurement of gas supply for its customers.***[5]

While Union has stated that it wanted to provide a more wholesome and transparent record, they have acknowledged the nature of the transactions have not changed from 2011.[6] That makes sense given that the Preliminary Decision clarifying these transactions as reductions to transportation costs was issued in mid November of 2012 when the lion's share of the transactions had been completed. Furthermore, Union had retained all of the same TCPL contracts into 2012[7]. In essence, nothing substantive has changed from 2011.

2. <u>Gas Transport delivers Molecules of Gas to Where the Gas is Needed</u>

Union has attempted to frame this concept of temporarily surplus capacity as a foundation for its new classification to distinguish between a transaction that generates revenue or reduces costs.[8]

[4] EB-2012-0087 Decision on the Preliminary Issue dated Nov. 19, 2012, page 27 citing EB-2007-0606, Settlement Agreement, Section 5.
[5] EB-2012-0087 Decision on the Preliminary Issue dated Nov. 19, 2012, pages 26 and 27
[6] Transcript Volume 2, page 9, lines 18-22
[7] Transcript Volume 2, page 157 lines 19-24
[8] Exhibit B, Tab 2, page 8

Union's Gas Supply plan is designed to get gas to where it is needed seasonally and to ensure its peak day market needs are met. The gas goes to meet market demand or goes to storage to meet subsequent market demand. In our respectful submission, this framing misses the point that getting the gas to where it needs to be at a prudently incurred cost is part of the undertakings of a utility who is given rights to a monopoly franchise. Simply put, Union has found ways of lowering the cost of annual contracts by managing the transportation of gas to where it needs to be in its role as a prudent utility.

The best example of this obligation of the utility to put the gas where it needs to be is found in Union's undertaking J2.6. In Union's own statements:

> ***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. 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.***

It is clear that Union has recognized this obligation. To the extent that they then use those assets in a different way to get the gas to the required destination, in our submission, it is a logical extension that the lowered cost should accrue to those who pay for the service. To do otherwise would create an over-recovery for the service.

3. <u>Union is Kept Whole for Under-recovered Transportation Costs</u>

Part of the regulatory construct is Union's ability to recover from ratepayers for transportation demand charges that for one reason or another are under-utilized. An amount of this forecasted under-utilization is recovered in rates. If more Unutilized Demand Charges ("UDC") are incurred due to, amongst other things, warmer weather, UDC creates a debit to the customers in the respective franchise area. This year, Union South customers incurred a debit balance of $2.3

million in UDC charges above those in recovered in rates.[9] The practical result is that Union is kept whole, dollar for dollar, on its use of transport and mitigation of temperature swings. If Union fails to respond to abnormally warm weather, ratepayers keep them whole through this mechanism.

Union has attributed this year's under-recovery to "significantly warmer than normal weather"[10] In addition, Union has stated in evidence that the substantial optimization transactions of $51.6 million were created as a result of warmer than normal weather[11]. In our view, how did Union have the foresight to see opportunities to assign transport or create exchanges in the market while not recognizing the opportunity to mitigate excess transportation demand for ratepayers. Leaving aside the conflict that is inherent in this situation, we would respectfully suggest that Union's approach ought to be reviewed further in this area.

To emphasize that point, we provide an excerpt from the oral hearing:

MR. ISHERWOOD: The planned UDC is one thing, but as you would expect from a gas control operational point of view, they want to make sure. So the supply length is -- can be handled any time during the summer. It can be handled in a variety of different ways.

And in March, especially in the north, from an operating point of view you would rather have the gas continue to show up than to start to mitigate.

MR. QUINN: Is there a policy or procedure that Union follows in this regard?

MR. ISHERWOOD: There's no formal policy or procedure, but there's a dialogue between the gas control group and the gas supply group.

MR. QUINN: Let just to make sure I've captured this correctly, even if you have planned UDC in March and you've had a warmer than normal January, the gas supply group will not release the transport until April, just in case it gets cold again?

MR. ISHERWOOD: As I just said, it would not be prudent to do mitigation in March, especially in the north. So the decision that we have made historically -- and I think it is the right decision -- is not to mitigate in April -- or, sorry, in March, and to begin that work in April and through the rest of the summer.

There's lots of time in the summer to mitigate; there's no urgency to do that in March.

[9] Exhibit A, Tab 1, Page 4
[10] Exhibit B, Tab 3, Page 45
[11] Exhibit B, Tab 2, Page 6

MR. QUINN (note to reader, this is Mr. Shorts speaking): And in addition to that, Mr. Quinn, there is UDC in every month in certain delivery areas in the north, but we -- again, for the same reason Mr. Isherwood just stated -- we do not look at the UDC mitigation or release that pipe in case there is a peak day in those periods.

MR. QUINN: So said differently, S&T optimizes all of the opportunities for March, and the UDC, your intention isn't turned to UDC pipe in the summer -– until the summer?

MR. SHORTS: It's not just, again -- the way we manage UDC or our balance may not be strictly by releasing pipe. So for example, we have Dawn purchases within the south portfolio that we used to actually not buy.

So there's no demand charge associated with that, so we would actually forego, for example, like we did in '12, buying four-plus pJs of supply that was planned to be bought, but to mitigate the balance, the imbalance, we had not purchased those supplies.

MR. QUINN: I think we focused a lot on the gas supply part of this, but Mr. Shorts, would you be able to anywhere either point to us by reference, by undertaking, where we would be able to see your UDC mitigation and the strategies that were employed by Union and the results for customers for 2012?

MR. SHORTS: I'm just trying to turn up the interrogatory.

MR. QUINN: I would be happy, sir, for you to just give us a reference afterwards, if you know that you have it.

MR. SHORTS: So for example, if we look at D8.1, we actually show on D8.1, attachment 1, the mitigation of our four UDC purposes for our gas supply plan.

And you'll see that they are listed by pipe, and that it gives -- the first is the demand charge, and then the released value. So those two numbers then give you the net UDC that went into the deferral account for 2012.

MR. QUINN: Kudos to you, because your memory is better than mine that this is our IR.

But I see March demand charged and the release value; can I conclude from that that there was actually March UDC mitigated?

MR. SHORTS: Yes. Because it was so uncharacteristically warm in 2012, we did actually start earlier in '12 than we would have normally done so in any other year.

MR. QUINN: I didn't want to debate with you the merits of starting in March, but I'm comforted by the fact you have.

From the above excerpt, it is clear that the stated practice is not always the rule. In our view, without a policy that lays out criteria or reporting that establishes accountability, judgment calls are more difficult to question in hindsight leaving the potential for perceived conflict, real or not. We would encourage the Board to direct Union to provide additional evidence as part of its 2013 Deferral Account disposition proceeding that addresses the issue of UDC management versus transportation optimization and the potential for a policy or guiding criteria to reduce the risk of conflict and ensure an effective balancing of interests.

In the interim, we emphasize that the choices made with respect to UDC can have a direct impact on optimization transactions. Separating the costs of UDC at 100% to the ratepayer while taking the benefits of the transportation optimization to profit with some potential ratepayer benefit above a threshold is, in our submission, inequitable.

4. <u>Proper Classification ought to be Driven by the Public Interest not Opportunistic Gain</u>

It is clear that when costs of services are predominantly borne by one sector of customers and profit shared disproportionately with others, there is room for preference in terms of benefit allocation. However, interestingly enough, in both EB-2012-0087 and EB-2011-0210, there was clear ratepayer consensus, if not unanimity, that the proceeds of FT-RAM were properly characterized as reductions to gas costs. It is clear that Union has attempted to garner support for its approach by presenting its views on the matter to industry associations by waiving the prospect of a cheque or an invoice[12]. Well-intentioned association executives could be influenced by the pursuit of membership interest if not fully informed of the public interest determinations of the Board. At the risk of offending other parties whose collaboration we value, we encourage the Board to weigh the submissions of the parties on this issue with due perspective.

In our view, for the reasons laid out above, we respectfully request that the Board reject Union's proposed allocation of transportation transactions and order the application of the criteria established in EB-2012-0087 as found in Exhibit B, Tab 4, Schedule 2.

[12] Transcript Volume 1, page 143 line 22 to page 146, line 13

B. Union's Response to Gas Supply Directive

The EB-2011-0210 decision addressed concerns with Union's gas supply planning process, methodology and resulting supply leading to a directive to Union for a review[13]. Union subsequently broke the directive into 3 tasks[14]. While we understand the desire to spread the work, in retrospect, the resulting division of labour left gaps that should have been studied. One such gap is the deferral account implications of the actual transactions that underpin operations meeting market demand (in this case specific to the transportation accounts). However, we respect that this is hindsight, so we will deal with the reports as presented.

We have no comment on the Concentric Energy Advisors report.

Union's Gas Supply Review looks at the planning and contracting process for winter of 2012/13 to evaluate process and sizing of assets. While it is clear that the time period of the review is different from the period being reviewed for deferral account disposition, that fact was lost sometimes in the oral hearing.[15] Notwithstanding their protestations, it is well known to the Board that Enbridge was using STFT to manage its winter peaks during 2012 for system reliability[16].

One area that Sussex did review was Union's approach to meeting design day market demand in the respective delivery areas. As was addressed through significant dialogue and ultimately Union's provision of J2.6 was the design day demand to the Union CDA. We will readily admit that the peak day demand to this area is complex and has become more important part of the "bottleneck" in recent years. Our attention was drawn to it as a result of the 96% optimization rate[17] and the increased capacity contracted just prior 2012[18].

[13] EB-2011-0210 Decision dated Oct. 25, 2012, pages 40-41
[14] Exhibit B, Tab 5
[15] Transcript, Volume 2, pages 124-126
[16] EB-2010-0231 Enbridge System Reliability
[17] Exhibit D8.12, Attachment 2
[18] Exhibit J2.6

In that most recently cited Exhibit J2.6, Union attempted to explain the demands of the area and how they are met. We make a couple of observations initially:

- Union states "Union does not separate individual cities or city gate stations"[19]. We understand that they do not do that. However, we know that TCPL would require a nomination to Union CDA that was met by their system and where the gas would be coming from (i.e., Kirkwall, Parkway/Maple). In our submission, Union would also need to know the demand to plan for design day deliveries to meet those obligations at Kirkwall or Parkway to meet security of supply. They have not provided that information.
- The "bottleneck" is a term that Union created in the Ontario Natural Gas Market Review.[20] This area has been the focus of the infrastructure proceedings for over a year because of the market constraints. Therefore the market has provided a considerable premium for gas getting through from Parkway to Maple (i.e., through the bottleneck).
- The incremental contracting from Union Parkway Belt to Union CDA would ensure Union's needed deliveries to the CDA can be made from Parkway, thus freeing up greater ability to divert gas from the Empress to Union CDA contract to Enbridge CDA.

The Board has spent a considerable amount of time over the last year coming to understand the infrastructure limitations in this area. We believe that it would be intuitively obvious that utilities and pipelines would have to coordinate and know what they can count on during design days. Yet, the utility has not been able to provide compelling evidence as to why additional contracting was necessary. The Reconciliation of Union CDA[21] shows incremental transport capability into the Union CDA for 2012 and 2013 without an attempt to balance these delivery capabilities with the respect demands inside the Union CDA or beyond. We have read and understood the explanations but without the balancing, in our view, the additional contracting is interpreted as additional flexibility.

[19] Exhibit J2.6, page 2
[20] EB-2010-0199
[21] Exhibit J2.6, page 3

Union has asserted that the plan is appropriately or right-sized throughout evidence and testimony. However, once established, the utility systematically sold the rights to the firm transport without ensuring the resulting contractual commitment is underpinned by firm transport.[22]

We are concerned that the study was limited only to the Gas Supply plan. We anticipated that this review would allow an expert to consider how the plan was implemented or using Union's term "operationalized".[23] We respect that this aspect gets beyond the specific directives of the Board but it gets to the heart of the matter between how Union plans for Gas Supply and how it ultimately meets market demand[24]. As a result, we have unanswered questions which we will reserve to a future time.

With these unanswered questions, while we do not believe that Union has established its case, we are unable to present a clear and compelling argument on our continued concerns regarding the "right-sizing" of Union's assets. Union has presented expert testimony supporting facets of its Gas Supply planning and Deferral Accounting. However, from our experience with understanding the utilization of and accounting for storage in previous proceedings[25], we understand it can take years to really understand complex issues. Further, even an independent expert review does not constitute a full analysis of implications when issues like hurdle-rate return on purchased services are not provided to the Board in the expert review.[26]

Based upon concerns coming into the hearing, which have not been relieved to this point, we had expected to argue for the application of the 90/10 ratepayer/shareholder sharing to be applied to all of Union's transactional services.. Given that this proportionate allocation in sharing is already in place for 2013 and 2014-2018, we are satisfied that a more equitable arrangement will be in place in the public interest moving forward. We are still left with more questions than answers on the "right-sizing" but will not argue, in good conscience for something we cannot

[22] Exhibit D8.28
[23] Transcript, Volume 1, page 157, line 26
[24] Exhibit D8.42 Supplemental
[25] EB-2009-0101, EB-2010-0039 and EB-2011-0038
[26] EB-2011-0038 Decision dated Jan. 20, 2012 pages 27-30

support with compelling facts and argument for 2012. We will, however, remain diligent in pursuing the balance between prudent in investments in security of supply and the cost and opportunity inherent in doing so.

C. Gas Supply Conclusions and Relief Requested

1) As laid out in section A, we firmly believe that the transactions in question are clearly reductions to transportation costs. Therefore, we respectfully request the Board to direct Union to apply the treatment of these transactions consistent with EB-2012-0087 and as found in Exhibit B, Tab 4, Schedule 2.
2) We respectfully request the Board to direct Union to provide additional evidence on UDC mitigation versus transportation optimization considering the establishment of criteria and reporting to ensure equity for ratepayers
3) We respectfully request the Board to direct Union to enhance its proposed Gas Supply Memorandum with a breakdown of TCPL contracts and their respective utilization

D. Other Issues

Given our focus on Gas Supply, our collaboration with others and our desire to be efficient, we offer only brief submissions on the following topics.

<u>Demand Side Management</u>

FRPO has previewed the submissions of the School Energy Coalition and support their rigorous examinations and recommendations.

Financial Reporting

We support Board staff's request for additional financial reporting based upon having utility and non-utility reporting combined currently. Further, we would encourage the Board to consider the current investment that ratepayers make in Union's current financial statements. When the Board gave the Union opportunity to receive market rates for non-utility storage early returns on equity were in the order of 39%[27] before Union stopped reporting on this. We believe the non-utility company ought to bear this cost as part of their privilege to earn the Board's confidence in the financial reporting of the combined utility.

Costs

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

All of which is respectfully submitted on behalf of FRPO,

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Dwayne R. Quinn

Principal

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[27] EB-2010-0039 Exhibit B3.41 Attachment