EB-2013-0109

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

REPLY ARGUMENT OF UNION GAS LIMITED

A. Overview

1. This is Union Gas Limited's Reply Argument in EB-2013-0109. This Argument should be read in conjunction with Union's Argument-in-Chief. For the reasons set out in that argument and below, Union remains of the view that the relief requested in the application should be granted by the Board.

2. To varying degrees, the matters identified in Union's Argument-in-Chief as being in dispute remain contested. The balance of this Reply Argument is organized to address each of these matters:

(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 in respect of Union's regulated utility business.

B. Treatment of FT-RAM Related Exchange Revenue

Proposed Treatment and Support

3. Union is proposing to treat net FT-RAM revenue as utility revenue subject to earnings sharing. The reasons for Union's proposed treatment are described in its Argument-in-Chief. Fundamentally, Union's position is based on the evidence adduced in this proceeding as applied to recent guidance from the Board, the historical treatment of exchange related revenues and the terms of the IRM Settlement Agreements.

4. Board Staff supports Union's proposed treatment of net FT-RAM revenue.[1] As Board Staff notes in its argument:

> Board Staff is of the view that in the current proceeding, Union provided **better, more thorough and complete evidence** explaining its FT-RAM related activities than it did in 2011. Board Staff notes that there were also some changes to the activities undertaken by Union in 2012 as compared 2011. [2]

5. Board Staff proceed to note that the Board's Decision in EB-2012-0087, "essentially set out two criteria" which need to be considered when evaluating whether FT-RAM related revenue should be treated as utility revenue: (1) the transaction must rely on temporarily surplus assets; and (2) the transaction must be unplanned.[3] (Union agrees with this submission, adding only in its Argument-in-Chief that the exchange must be sold as service to a third party.) The balance of Board's Staff's argument then compares the more complete evidentiary record adduced in this proceeding to these criteria. As it concludes:

> Board Staff is of the view that the Summer/Shoulder Month and Winter Exchange Transactions (Lines 4 and 5 in the table set out above) rely on temporarily surplus assets. Board Staff notes that Union described in detail, in Section 12.1 of its

[1] Board Staff does suggest a slight reduction of $0.7 million to the net FT-RAM revenues on the basis that a design day might occur in March and, therefore, the assets used were not temporarily surplus (Board Staff Argument, p. 13). Union disagrees with this reduction on the basis that the evidence at the hearing is that a design day has never occurred in that month.

[2] Board Staff Argument, p. 10

[3] Board Staff Argument, p. 11

application, the operation of these transactions. **Board Staff is convinced by this evidence which highlights the surplus assets that were used to support the transactions.** As such, Board Staff submits that the revenues associated with those transactions are appropriately treated as utility earnings in the context of Union's IRM Framework.

* * *

In regards to the Winter combined Assignment/Exchange transactions (Line 7 in the table set out above), Board Staff notes that, in general, there would not be any temporarily surplus assets available to support these winter month transactions. As agreed to by Union, at the time of the sale of a Winter combined Assignment/Exchange transaction, Union cannot be certain that a design day will not occur. On a design day, there would not be any temporarily surplus assets available to support the transaction. However, Union noted that the majority of its Winter combined Assignment/Exchange transactions that took place in 2012 are related to the optimization of the TCPL Empress to Union CDA contract. Board Staff submits that the unique nature of Union's use of this contract (as discussed previously) allows that, even on the design day, temporarily surplus assets would be available to support transactions that utilize this contract. **Board staff is convinced by Union's evidence that its 2012 Winter combined Assignment/Exchange transactions rely on assets that are temporarily surplus to the needs of Union's customers as they are supported by capacity on Union's CDA contract.**

In regards to the Summer/Shoulder Month combined Assignment/Exchange transactions (Line 6 in the table set out above), **Board Staff is of the view that Union did have temporarily surplus capacity available in the summer months of 2012 to support these transactions. Board staff finds the evidence in Section 12.2 of Union's application which highlights the surplus assets that were used to support the transactions convincing.** Therefore, Board Staff submits that the revenues associated with those transactions are appropriately classified as Transactional Service revenues (and should be treated as utility earnings in the context of Union's IRM Framework).[4] [Emphasis added.]

6. Likewise, APPrO supports Union's proposed treatment of net FT-RAM revenue. APPrO addresses the essential point (confused in other arguments discussed below) that there is no contradiction between a prudent gas supply plan and S&T Activity:

Utilities must design their supply portfolio to accommodate their design day requirements. Utility portfolios serving heat sensitive customers will often have a

[4] Board Staff Argument, p. 12

> temporary surplus of transportation capacity at off-peak times of the year as design day conditions only occur in the winter. Utilities must, however, be prepared to serve their design day demands every year. This dispels the notion that Union contracts for excess transportation capacity on a plan basis to incur unabsorbed demand charges…and related FT-RAM credits.[5]

7. APPrO further highlights in its argument the following three facts, from the record, which are consistent with Union's proposed treatment: (1) Union does not rely exclusively on upstream transportation contracts to generate FT-RAM exchange revenues (Union relies on other transportation assets; for example, its Dawn-Parkway system to execute the exchanges); (2) the terms of the IRM Settlement Agreements; and (3) the fact that Union was at risk for a base level of exchange revenue during IRM. [6]

8. As APPrO notes in relation to (3), as part of the IRM Settlement Agreements, "Union took on the risk during the IRM of generating sufficient transportation exchange revenue to generate this amount of exchange margin. In the event that Union was not able to generate this $6.9 million in margin in any year, ratepayers would not expect Union to try to subsequently recover the resulting shortfall in rates." [7]

Response to Parties Opposed to Union's Proposed Treatment

9. The balance of the parties disagree with Union's proposed treatment of net FT-RAM revenues. The over-arching response to parties opposed to Union's proposed treatment is that each of their arguments focuses, substantially, on the result in EB-2012-0087 without regard to the rationale for that decision. Few of the arguments discuss in detail the evidence in this proceeding. Union agrees with Board Staff's observation that "it is incumbent upon the Board to consider the evidence before it now to assess whether there is a reasonable basis for the Board to depart from the decision and reasons rendered in the 2011 ESM case [EB-2012-0087]. The Board is not bound by the 2011 ESM decision".[8] To the same effect is the Board's own observation in EB-2013-0046.

---

[5] APPrO Argument, p. 4

[6] APPrO Argument, pp. 4-6

[7] APPrO Argument, p. 6

[8] Board Staff Argument, p. 10

10. Further, the arguments suggest that the transactions undertaken by Union in 2011 were the same as those undertaken in 2012. Not only in this statement wrong in material respects (as discussed below) but it is largely beside the point. Relevant are the circumstances surrounding the transactions: do they align with the Board's criteria, not whether the form of the transactions was the same.

11. In what follows, we respond further to each parties' argument.

12. **CME**. CME's argument in relation to the proper treatment of net FT-RAM revenues does not begin in earnest until page 8. The preceding pages discuss the result in EB-2012-0087 and compare the topics discussed in that case relative to this proceeding. But, Union does not dispute that, at a high level, the topics discussed are comparable. That is not the issue. What matters is the evidence in relation to those topics. As CME elsewhere admits, the record in this proceeding is "more detailed" both with respect to "Union Gas Limited's supply plan and the range of FT-RAM optimization activities in which Union engages". [9]

13. As Union indicated in its Argument-in-Chief, it does not seek to vary the Board's decision in EB-2012-0087; rather, Union proposes a different treatment for FT-RAM related revenues, based on a different, more complete evidentiary record, which responds directly to the Board's decision-making criteria.[10]

14. The fact that CME's argument is based on the result in EB-2012-0087 and not the rationale for that decision is exposed on page 11 and 12 of its argument. For example, among other things, there CME dismisses the Board's decision-making criteria of planned activity and temporarily surplus by stating:

- 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 …

[9] CME Argument,, pp. 8-9, para. 24
[10] Union Argument-in-Chief, p. 4, para. 11

- 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. [11]

15. CME's argument reflects a complete departure from the Board's reasoning in EB-2012-0087 and EB-2012-0055. In both decisions, the Board indicated that the key distinction when determining if proceeds from S&T Activity were to be treated as revenue versus a gas cost reduction was whether the underlying transportation assets were "temporarily surplus" to system sale and bundled direct purchase customer needs. As the Board held in EB-2012-0055:

> The essential characteristic of transactional services is that they are arrangements made to generate revenue from unplanned, temporary surplus transportation capacity that Enbridge may have, from time to time, as part of its gas supply arrangements. [12]

16. Equally, the Board held in EB-2012-0087 that:

> 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.[13] [Emphasis added, Page 28]

17. Effectively unable to respond to the application of the Board's criteria to the evidence in this proceeding, CME's argument proposes a new criterion upon which it suggests the Board should base its decision. It says that the decision should be based on whether Union made a "decision" to use a different method to deliver gas from that specified in the gas supply plan. The argument goes on to say that the decision to make such a change is a matter within Union's control and therefore the revenues should be treated as a gas cost offset. CME purports to define this criterion as "transportation switching." [14]

---

[11] CME Argument, pp. 11-12

[12] Exhibit B, Tab 1, p. 36

[13] Exhibit B, Tab 1, p. 36

[14] CME Argument, pp. 11-12

18. Similarly, CME resorts to the evocative term “savings” to describe the revenues realized by Union from the sale of exchanges.[15]

19. With respect, CME’s criterion is no criterion at all and is inconsistent with the criteria already established by the Board. Further, its attempt to re-characterize revenues as savings does nothing to advance the substantive issues raised by the application. In both cases CME’s definitional characterizations should be disregarded.

20. Of course the decision to depart from the gas supply plan is a decision made by Union and one that is within its control. All decisions with respect to utility operations are within Union’s control. Further, the very essence of exchanges transactions is that they represent, at least in part, a decision by Union to depart from the gas supply plan because the assets are temporarily surplus. Union has admitted as much throughout its evidence and in testimony at the hearing. As Ms. Piett said:

> If we didn't do the assignment and **chose not to optimize**, we would be on figure 1, and we could do that all day long. **And we could flow gas exactly the way the gas supply plan had indicated, and what would happen was we would have surplus capacity that was shown in figure 2 that would be un-utilized**.
>
> And that would be, presumably, a cost to the market, because we would have assets that aren't fully deployed.[16] [Emphasis added.]

21. The fact that Union has chosen to depart from the gas supply plan does not, however, change the fact that the transactions at issue were (1) served by some quantity of the upstream transportation capacity that was not required on a temporary basis to meet market area needs; (2) unplanned in the sense that the transaction was not included in the gas supply plan (nor, as Sussex confirmed, should it have been)[17]; and (3) sold as a service.

22. The focus of the EB-2012-0087 Decision was not on whether Union “chose” to engage in an optimization transaction but whether Union had chosen or planned to have too much transportation capacity in the gas supply plan which Union then used to underpin exchange

[15] CME Argument, p. 1
[16] Transcript, Volume 2, p. 20
[17] Transcript, Volume 2, p. 83

transactions. The Board was concerned that Union's gas supply plan was driven, in part, by optimization activities and that Union had "manufactured opportunities." The evidence in this case fully addresses the Board's concerns.[18] As set out in that evidence and in Union's Argument-in-Chief, Union's gas supply plan is "right-sized" and the only optimization transactions Union has treated as utility revenues are those which meet the Board's criteria.

23. In the lead up to this aspect of CME's argument, CME purports to describe the features of an FT-RAM related exchange transaction and an FT-RAM related assignment. Union disagrees with CME's descriptions. The nature of these transactions is described in extensive detail in Exhibit B, Tab 2. Union relies on that evidence and the evidence at the hearing. For example, contrary to CME's submission[19], in the case of a capacity assignment, the third party pays TCPL the full toll (not some greater amount) and in turn the third party invoices Union for this payment. The third party then pays Union an amount that reflects the value of the S&T transaction as a whole. TCPL capacity was never valued above its toll in 2012 (i.e., it was always out of the money). It is therefore wrong to suggest that the elements of the transaction could be undertaken in parts and Union could have simply released capacity for more than it was worth. Had Union done the transaction in parts as suggested by CME, Union would have lost money on the release as no party would pay more than the TCPL toll. Union would then have also had to buy an exchange which would have increased the size of the loss.[20]

24. CME purports to bolster its argument by trying to draw a distinction between FT-RAM related exchanges and "base exchanges". It says that base exchanges are different because "no decisions must be made to change the method from 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". [21]

25. The evidence directly contradicts CME's assertion in relation to base exchanges. Exhibit B, Tab 2, Section 9 describes a base exchange. On any fair reading of that evidence, it is clear that base exchanges and FT-RAM related exchanges are the same and that both involve a

[18] Exhibit B, Tab 1, p. 5
[19] CME Argument, pp. 9-10
[20] Transcript, Volume 2, pp. 35-36
[21] CME Argument, p. 13, para 37

departure from the gas supply plan. For example, under the heading "Operational Results" in Case 1 (which describes a "One Day Base Summer Exchange") after explaining in earlier paragraphs what would have happened pursuant to the gas supply plan, the evidence provides:

> Case 1, Figure 3 illustrates that **S&T has arranged to deliver (divert) the gas to the S&T Customer at Enbridge CDA**. The S&T Customer provides the same quantity of gas to Union at Dawn. In both Figure 1 and Figure 3, Union purchases the gas supply at Empress and takes delivery of the same quantity of gas at Dawn. [22] [Emphasis added.]

26. To use CME's words, in this example, Union has made a "decision … to change the method for moving utility gas to Union's system from points upstream". Rather than transport gas from Empress to Union EDA (where consumption is lower than the total gas supply available) for subsequent re-delivery (from the EDA to Dawn) and injection at Dawn using TCPL STS, Union has sold an exchange to an S&T Customer which obliges that customer to deliver the needed quantity of gas at Dawn. Union continues to purchase the same volume of gas molecules at Empress and delivers that volume at Dawn as required by the gas supply plan.[23]

27. Ms. Piett walked through the above example and others in her examination in chief. As she described, the fact that Union has temporarily surplus assets is the same for both types of exchanges as is the fact that Union has to must chose to optimize. What is different is the form of the transaction and the extent of the revenues, having regard to the terms of the FT-RAM program.[24]

28. CME makes two further arguments under the heading "Implications of a Utility Revenues Classification." First, it raises the question of whether the portion of those revenues which Union proposes to allocate to its shareholder is appropriate; and second, whether the allocation to ratepayers of the remaining amount is being made to the appropriate rate classes. The first argument is discussed immediately below. The second is discussed more generally under the "Allocation of Net FT-RAM Revenues".[25]

---

[22] Exhibit B, Tab 2, p. 40

[23] Exhibit B, Tab 2, pp. 39-40

[24] Transcript, Volume 1, p. 125

[25] CME Argument, p. 15, para. 46

29. CME essentially questions whether the level of sharing of net FT-RAM revenues is appropriate. It suggests that the "range of reasonableness" for the incentive is between 10 and 25 per cent.[26]

30. This aspect of CME's argument fundamentally disregards the terms of the IRM Settlement Agreements. Pointing to the incentive prior to 2007, the incentive under the next generation of IRM (2014-2018) or even the incentive that may be applicable to utilities elsewhere in North America is unhelpful. The only relevant question – because this case concerns 2012 revenues – is what were the terms of Union's Board-approved IRM Framework for the period 2008-2012. On this question, there is no dispute. All exchange revenues are to be treated as utility revenues subject to earnings sharing. It is also worth noting, as APPrO does, that delivery rates already include an amount for S&T activity.[27] Until Union achieves this level of revenue it receives no incentive at all.

31. **BOMA**. BOMA's argument is not grounded in the record in this proceeding. In a nutshell, it is a plea for consistency of result over a proper consideration of that record.

32. In any event, Union disagrees with BOMA's statements with respect to the prior proceedings. BOMA's assertion that the Board was not concerned in EB-2012-0087 with the status of Union's gas supply plan and whether it was appropriately sized is contradicted by the Board's own words. As set out above, the Board held that, "…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." [28]

33. Also relevant is what the Board said in EB 2011-0210, which was heard and decided at roughly the same time:

[26] CME Argument, p. 19, para. 53
[27] APPrO Argument, pp. 5-6
[28] EB-2012-0087, Decision and Order on Preliminary Issue, p. 28

> Although the issues of optimization and natural gas supply planning are listed separately on the issues list, it is evident to the Board from this proceeding that the issues are, in fact, inter-related. [29]

34. The Board further indicated that it had a concern that Union's optimization activities were, "in their own right", a driver of the gas supply plan, and no longer a consequence of it. It was for precisely this reason that the Board ordered a review of Union's gas supply plan, its planning process and its planning methodology.[30]

35. As described above and in Union's Argument-in-Chief, the evidence adduced by Union in this proceeding responds directly to the Board's concerns and its criteria as they relate to S&T activity. The evidence shows Union's gas supply plan is right sized and that the upstream transportation assets underpinning Union's gas plan are contracted based on well-accepted gas supply planning principles. The plan does not consider opportunities for optimization; that is, optimization is not a "driver" of the gas supply plan.[31]

36. BOMA refers to the fact that treating the cost of gas and upstream transportation as pass through items is a long-standing regulatory principle.[32] Other parties make the same statement. It does not advance the discussion at all. Equally, Union has a long history, dating back to the early '90s, of engaging in Board-approved exchange activities. The objective of these activities has always been to generate revenues by optimizing temporarily surplus transportation assets. The revenues have been treated in a variety of different ways over time, but they have always been shared between ratepayers and Union. [33]

37. Like CME, BOMA also points to the terms of the next generation IRM Framework as though it were evidence of the terms of the IRM Framework in 2012.[34] Clearly, this is wrong.

38. **CCC**. CCC advances many of the same arguments as CME. Those are discussed above. CCC also bases its position on the following assertion:

---

[29] EB-2011-0210, Decision and Order, p. 35
[30] EB-2011-0210, Decision and Order, p. 36
[31] Union, Argument-in-Chief, p. 3, para. 9
[32] BOMA Argument, p. 5
[33] Union, Argument-in-Chief, p. 5, para. 13-14
[34] BOMA Argument, pp. 2-3

> If efficiencies are created through the implementation of better gas supply planning those efficiencies should be translated as gas cost savings, and allocated to the benefit of those customers that paid for the assets embedded in the plan. Gas costs are clearly a pass through item, as dictated by the original settlement agreement. From the Council's perspective it is really not any more complicated than that. [35]

39. There are at least two significant flaws in CCC's assertion. First, the FT-RAM related exchange transactions at issue are not the product of "better gas supply planning". As Sussex confirmed "better planning" does not have regard to optimization. In fact, it would be inconsistent with established gas supply planning principles for it to do so. As Mr. Stephens stated, "the mitigation of the gas supply plan is a secondary activity to actually developing the gas supply plan… it really is a sequence…and step two never influences step one."[36] Second, taken to its logical conclusion, CCC's assertion would gut the terms of the IRM Settlement Agreements and mean that Union agreed to increase the forecast level of exchange activity in base rates for no consideration at all. This makes no sense.

40. **LPMA**. The main argument made by LPMA is that the "transactions do not rely on temporarily surplus assets – Union has clearly indicated that the assets are still required to bring in the gas purchased." LPMA goes on to say that the assets "would only be surplus if it did not have gas, needed by its customers, to transport." [37]

41. With respect, LPMA's argument confuses the issues of temporarily surplus and UDC. In the latter case, Union does not need the gas molecules to serve its market areas. To address having too much supply, Union stops buying molecules and assigns the upstream pipe to a third party. Any revenue from the assigned capacity is credited to ratepayers to offset UDC costs. In the former case, Union continues to require the gas molecules and continues to purchase the gas molecules from the same location; temporarily surplus assets (capacity) are available because the entire portion of the transportation path is not required (e.g. to bring gas to Dawn but not to the market area, as illustrated in evidence,[38] as well as each subsequent illustrated case and discussed

[35] CCC Argument, p. 4
[36] Transcript, Volume 2, p. 83
[37] LPMA Argument, p. 2
[38] Exhibit B, Tab 2, pp 23-29

in testimony.[39] Union's proposed treatment only addresses those transactions which are based on the use of temporarily surplus assets.

42. LPMA further asserts that Union "could have reduced the cost of delivered gas through the use of RAM credits."[40] In fact, Union did – credits were first applied to reduce LBA fees (see Exhibit D7.18).

43. LPMA's similar argument that FT RAM credits are "credits that should be accounted for as a reduction to the cost of gas"[41] is also wrong. The credits do not represent a refund to customers that can be applied against the cost of transportation. Action is required to convert the value of the credits against transactions undertaken. Union took this action to first apply as many credits as possible against in-franchise activity for system sales and bundled direct purchase customers. The remainder was used to monetize the value of temporary surplus asset that existed and could be used for sale on the secondary market.[42]

44. **Energy Probe** argues that the issue of the proper treatment of FT-RAM related revenues and base exchange revenues should be determined on the basis of what it describes as "cost causality". It argues that because the majority of transportation exchange revenues generated from upstream assets paid for by system sales and direct and bundled direct purchase customers in the North they should receive substantially all of the benefit (90%) of the revenues associated with the FT-RAM related exchange transactions. Cost causality is a cost allocation principle, it is not concerned with the classification of the revenues at issue. At best, Energy Probe's argument reflects a view as to which rate classes should receive the benefit of the net FT-RAM revenues after earnings sharing.[43]

45. Union also disagrees with the various alternative proposals put forward by Energy Probe as they do not flow from the terms of the IRM Settlement Agreements.

---

[39] Transcript, Volume 2, p. 122 line 16 to p. 124 line 28
[40] LPMA Argument, p. 2
[41] LPMA Argument, p. 2
[42] Exhibit B, Tab 2, pp. 10-12
[43] Energy Probe Argument, pp. 9-10, para. 32

46. **SEC**. SEC essentially makes the same argument as CCC. SEC says that "all optimization activities are essentially gas supply activities, and so should be for the benefit of gas supply customers." For the reasons set out above, this argument should be rejected. [44]

47. **FRPO**. FRPO's argument is difficult to follow, combining a variety of unrelated concepts into its discussion.

48. Like LPMA, it appears to confuse the issues of S&T Activity and UDC. It also appears to argue that Union has an obligation to pass-through to ratepayers the benefits of all optimization activities, including FT-RAM related exchange activity on the basis that Union has that obligation as a prudently-run utility.[45] This cannot be correct. If it were, and as described above, the terms of the IRM Settlement Agreements would be meaningless. On this theory, Union would have agreed to reduce the revenue requirement in rates by increasing the S&T margin embedded in rates in exchange for giving away any incentive at all to engage in that very activity. No rational utility would make that bargain. Union did not.

49. **OGVG/VECC**. Both of these parties assert that the transactions undertaken by Union in 2011 were the same as those undertaken in 2012. As a result, they say, the same decision should obtain. As described above, this statement is manifestly wrong: Union did not enter into any annual assignments in 2012.[46] Union's winter exchange activity in 2012 focused on the Union CDA and not the Union EDA contract, a fact highlighted by Board Staff in its submissions. Further, even if it were correct that Union, at a high level, engaged in the same "types" of FT-RAM transactions that is beside the point. What is relevant are the circumstances surrounding the various transactions, when were they were undertaken and whether the assets used were temporarily surplus or not. OGVG and VECC fail to properly engage in this requisite analysis.

Allocation of net FT-RAM revenues

50. A number of parties suggest as alternative relief that the Board should vary the rate classes which would benefit under earnings sharing if the net FT-RAM were treated as utility

[44] SEC Argument, p. 31, para. 4.1.2
[45] FRPO Argument, p. 3
[46] Exhibit B, Tab 2, p. 13

earnings as proposed by Union. Union does not agree with this alternative treatment of utility revenues.

51. Under the terms of the IRM Settlement Agreements all revenues are treated as utility earnings. The method for distributing earnings sharing amounts has always been based on the allocation of 2007 Board-approved return on equity.[47] There is no reason to depart from that allocation methodology now. Earnings in 2012 and earlier years were driven by a number of factors, not just net FT-RAM related revenues. The "contribution" of rate classes to those earnings has varied but the allocation method has not. It is also wrong to suggest, as some intervenors do, that only system supply and bundled direct purchasers pay for the assets underpinning the FT-RAM related transactions. In fact, as described above, Union used a variety of assets to serve the transactions, including the Dawn-Parkway system the cost of which is allocated more broadly.

C. Union's response to the gas supply directive

52. Board Staff and CCC state explicitly that Union has properly responded to the Board's directive that Union "file with the Board an expert, independent review of its gas supply plan, its gas supply planning process, and gas supply planning methodology." Board Staff indicates that it has reviewed Union's evidence and the Sussex report and has no issues with either.[48] CME relies on Board Staff.[49]

53. FRPO is critical of Union's response. LPMA adopts FRPO's criticism. Despite these parties' positions, neither is able to articulate a single, specific change which should be made to Union's gas supply plan, its planning process or the gas supply planning methodology. As FRPO says, "we are unable to present a clear and compelling argument" for any change. [50]

54. FRPO's position is truly frustrating. It appears to reflect argument for argument's sake. For example, in respect of the fact that the directive was broken into two parts: one dealing with gas supply related issues and the other concerned with cost allocation issues, FRPO says that the

[47] Exhibit A, Tab 3, p. 7
[48] Board Staff Argument, p. 6
[49] CME Argument, p. 20, para. 57
[50] FRPO Argument, p. 9

"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…"[51] FRPO does not say what these implications might be; what other gaps exist in its view; or even how these gaps should have been studied. Its submission also blithely disregards the fact that:

(1) Union provided the RFP in relation to the directive to all parties before it was issued;

(2) FRPO did not comment on this aspect of the RFP, although it did comment on other aspects and its comments were adopted by Union;

(3) The response to the Board directive was ultimately awarded to expert consulting firms (Sussex and Concentric) based on selection criteria provided to all parties and which included relevant experience as a criterion;

(4) Concentric was tasked with examining the natural gas supply deferral and variance accounts[52]; and

(5) FRPO's own acknowledgment that it has "no comment on the Concentric Energy Advisors report."[53]

55. Similarly frustrating are FRPO's comments regarding the Union CDA. The comments disregard entirely the evidence and the response to Exhibit J2.6 in particular. FRPO says that the "Reconciliation of Union CDA" shows incremental transport capability into the Union CDA for 2012 and 2013." This statement is simply wrong. Union had the same capacity in those years as it had in earlier years. As fully explained in Exhibit J2.6, The only thing that changed was TCPL's contracting requirements and, in 2012, the contract counterparties (because TCPL no longer had capacity in that year, Union was required to source the same capacity in the secondary market)...[54]

[51] FRPO Argument, p. 7
[52] Exhibit B, Tab 5
[53] FRPO Argument, p. 7
[54] FRPO Argument, p. 8

56. FRPO also bases its argument on balancing it says Union would have to do. FRPO called no evidence of its own to back up its assertion. When it was put to Union, it was flatly rejected. As Union has explained, it does not plan, nor contract for individual city gates independently in determining its gas supply arrangements for Union South. [55] Saying something must be "intuitively obvious [to FRPO]" does not make it a fact.

57. In Union's submission it has responded appropriately to the Board's directive. The Board should deny FRPO's request for further direction in relation to UDC or to direct the content of the gas supply plan memorandum Union has already undertaken, on Sussex's recommendation, to prepare.[56]

D. Demand Side Management – Custom Projects

58. SEC has made multiple assertions about Union's custom project portfolio for which there is no basis in the evidence. SEC did not pre-file any evidence and the various definitions included in its argument were not put to Union's witnesses.[57]

59. Custom projects are unique, singular, and complex in nature and cannot be simplified in the manner set out in SEC's argument. Each project is assessed on a case by case scenario. The nature of custom projects is such that the issues of base case, effective useful life ("EUL"), and persistence cannot be examined in isolation. Their interrelationship can only be effectively considered by modeling project inputs to determine the appropriate level of savings. This work is completed by Union's technical experts and verified internally by professional engineers.[58] As Ms. Kulperger testified, "we have quality control engineers who would review every aspect of the project file to ensure that the baseline assumption was a reasonable one."[59]

[55] Exhibit J2.6; see also, Transcript, Volume 2,, pp. 217-219
[56] FRPO Argument, p. 10
[57] SEC Argument, Section 2 – DSM Principles and Comments, para. 2.2.1 through para. 2.6.6
[58] Exhibit D4.2, Attachment 1, p. 64
[59] Transcript, Volume 3, p. 136

60. Custom projects are further reviewed and verified through an independent verification process that includes trained technical experts including professional engineers. The selection of these independent verification consultants was done in consultation with Union's EAC[60].

61. As discussed further below, the Board should reject SEC's various definitions and application of the principles relevant to DSM. To begin, SEC confuses the rules applicable to the 2007-2011 DSM Framework with those applicable to the 2012-2014 DSM Framework. For example, the rules that now apply relating to input assumptions did not apply for 2011. It is important not to confuse the two Frameworks. Union has applied the DSM Framework applicable to the 2011 program year in determining its 2011 program results.[61]

Free Ridership

62. The EB-2006-0021 DSM Generic Proceeding for DSM programs for the 2007–2011 period was clear on the treatment of free ridership. Issue 3.1[62] stated:

> Parties agree that input assumptions such as **free rider rates**, prescriptive measure savings assumptions, incremental equipment costs, measure lives and avoided costs (natural gas, electricity and water) shall be based on research utilizing the best available data at the time a multi-year plan or new program or significant new program design is developed. These assumptions shall be assessed for reasonableness prior to implementation of the plan or program and should be reviewed and updated on a regular basis during the plan period as part of each Utility's ongoing evaluation and audit processes.

Issue 3.3 further stated:

> SSM - Assumptions used from the beginning of any year will be those assumptions in existence in the immediately prior year, adjusted for any changes in the audit of that prior year. By way of example, if in June of 2008 the audit of the 2007 programs demonstrates a change in assumptions, that change shall apply for SSM purposes from the beginning of 2008 onwards until changed again."[63]

---

[60] Transcript, Volume 3, p. 59

[61] In response to an interrogatory from SEC, Union described how the Technical Evaluation Committee developed a revised Custom Project Savings Verification process in June 2012 that was applicable for 2012 going forward. (Exhibit D4.4)

[62] EB-2006-0021, Phase 1 Decision with Reasons, p. 10

[63] EB-2006-0021, Phase 1 Decision with Reasons, p.11

63. Union's sector-specific custom free ridership rates were filed and approved in the 2011 DSM Plan proceeding (EB-2010-0055) and adjusted to a single free rider rate of 54% in the 2009 audit (as a result of an audit recommendation), which was agreed to be applied on a custom portfolio basis.[64] This rate has been applied for SSM in 2010 onwards with support from Union's EAC, as stated in Union's Argument-in-Chief (para.72). The 54% represents the Board-approved rate for the 2011 program year, and no changes arose in the 2010 Audit. This is the appropriate rate to apply for 2011 SSM.

64. In its argument, SEC attempts to draw a distinction between "conventional" free ridership and "known" free ridership, stating "the free rider percentage used to adjust program results is not intended to capture known free riders, and the Applicant cannot rely on that percentage to excuse paying ratepayer funds with no reasonable prospect of any benefit."[65] Union strongly opposes this characterization; it is not based on the Generic Proceeding.

65. Union does not target its program towards projects it knows would provide equivalent savings absent program support. However, Union is aware that a portion of the custom portfolio's deemed savings supported through Union's customer incentives and technical expertise would have occurred absent the program. This is captured in the 54% free rider rate applied to the custom portfolio. All free ridership is included in this rate. The 54% custom free ridership is based on a comprehensive study conducted by Summit Blue Consulting, which assessed free ridership as "customers who received an incentive through an efficiency program, yet would have installed the same efficiency measure on their own had the program not been offered. This includes partial free riders, defined as customers who, at some point, would have installed the measure anyway, but the program persuaded them to install it sooner than otherwise."[66]

66. The comprehensive study was based on actual projects covering all types of measures (HVAC, machine process, steam traps, etc). The overall pool of customers, participants,

[64] EB-2006-0021, Phase 1, Decision with Reasons, p. 44

[65] SEC Argument, p. 8, para. 2.2.14

[66] Summit Blue Consulting, LLC (October 31, 2008) Custom Projects Attribution Study, Prepared for Union Gas Limited and Enbridge Gas Distribution. p. i

methodology to assess savings and the types of custom projects Union has incented has not changed significantly since the time of the study.

67. Partial free ridership was included in the scope of the comprehensive custom free rider study. This calculated the impacts of the interrelated inputs of base case, EUL and persistence where advancement was deemed to occur. To include this factor in an advancement adjustment would result in double-counting.

68. Contrary to SEC's claim (para 1.2.4), there is a causal relationship between Union's programs and the results. As explained by Ms. Lynch, Union has a key role in influencing customers' decisions when it comes to the implementation of custom projects. This is in large part due to the ongoing efforts from Union account representatives and engineers to provide expertise to customers in helping to understand ways in which to make efficiency improvements:

> MS. LYNCH: Critical to our custom program is the ongoing relationship that we have with the customers. It doesn't relate to any one specific year even. This has been a longstanding program that we've had. We've worked with customers for many years, and all of that influences the decisions and the projects that they choose to undertake.
>
> As Ms. Kulperger pointed out, it's not specifically an incentive that is as influential as the overall expertise that we're able to provide and help customers with how they operate their facilities. [67]

Base Case, Effective Useful Life and Persistence

69. Industrial projects by their nature are complex and routinely customer/process specific. Union helps customers assess, implement and judge their energy efficiency effectiveness and productivity based of their previous state(s).

70. In Ontario, there is no industrial energy efficiency regulation mandating industrial customers to minimum baseline process efficiency. Union works with the customer to determine the appropriate base case on a project-by-project basis. This practice has been confirmed as appropriate by the independent verification firms and the DSM auditor.

[67] Transcript, Volume 3, pp. 95-96

71. SEC states that "Union and its CPSV contractors have treated the useful life of custom project measures as being the technical life, and have ignored the concepts of persistence and advancement".[68] This is inaccurate. Union does not limit its assessment of EUL to technical life. Union assesses the life for which the savings are planned to persist on a custom basis for each project.

72. As SEC notes in its showerhead example, persistence studies are conducted on easy-to-install measures to confirm that they were installed and have not been removed. With respect to persistence, historically the tradeoff between accuracy and costs associated with developing persistence factors has not been deemed to warrant a study for Union's custom portfolio. However, going forward, it is expected that a persistence study will be conducted[69].

73. Overall, SEC again confuses the Framework in place for 2011 by referencing the DSM guidelines , which were not included in Union's DSM Framework until the 2012-2014 DSM Plan. For each project, base case, EUL and persistence were reviewed by Union's technical experts and verified internally by professional engineers. The projects were then further reviewed and verified independently. The fact that executive summaries of the detailed verification reports, and not the report themselves, were provided to the EAC during the audit process does not mean that the results of the verification were incorrect or deficient. That was the accepted practice at the time.

SEC's Proposed Reductions to SSM and LRAM

74. It would not be appropriate for the Board to make the adjustments to SSM and LRAM proposed by SEC. The simplified approach put forward by SEC in no way accurately accounts for the rigorous assessment required to appropriately identify the savings from complex custom projects.

75. SEC selectively chooses what it deems to be shortfalls in Union's review of certain projects as a reason to make adjustments to the audited 2011 DSM results. As described above,

[68] SEC Argument, p. 10, para. 2.4.6
[69] Transcript, Volume 3, p. 142

the assumptions underlying the projects in question were appropriate and reviewed by experts, and the portfolio free ridership rate was appropriately applied.[70]

76. For instance, SEC states "a reasonable person" would have made different conclusions about whether a particular customer would have undertaken steam leak repairs. Mr. Clarke specifically cautioned at the hearing that "One has to be very cautious in making those kind of conclusions." He added that some steam leaks could be high off the ground, "requiring isolation of production units and actually bringing production elements off-line for repair. So you cannot make any categorical statement as to whether or not they would repair them. It's a case-by-case basis".[71] Considering that Union has hundreds of custom projects per year, it is for precisely this reason that a portfolio approach to free ridership is appropriate. Anything else would be unduly burdensome. Union further agrees with BOMA's observation that "to decide in any particular case when and whether a company would take action in the future to replace a leaking steam trap or pipe or any piece of equipment depends on a number of factors and is, for an outside third party, pure speculation."[72]

2012 Audited Results

77. SEC further references unaudited 2012 results in paragraph 3.2.3. Union filed its 2012 Audit documents with the Board on October 30, 2013 and reflected the updated balances in an evidence update dated November 4, 2013. This was discussed in Union's Argument-in-Chief at paragraph 73.

78. LPMA supports the practice of clearing the DSM accounts on a provisional basis, with a true up in the following year[73], submitting that it is appropriate in order to reduce the carrying costs to be recovered from ratepayers.

79. In Union's submission, it is appropriate to dispose of the 2012 audited DSM balances in this proceeding because:

---

[70] In addition, at the hearing, Union took certain TRC related calculations subject to check. Those figures have now been reviewed by Union. There are certain inaccuracies which Union will address in a confidential communication.

[71] Transcript, Volume 3, p. 98

[72] BOMA Argument, p. 11

[73] LPMA Argument, p.10

(1) the 2012 Audit Committee has accepted the balances in the subject DSM deferral accounts and supports an order from the Board disposing of the amounts through to rates;

(2) waiting to recover these amounts in the following year only adds the carrying cost to the amounts to be recovered from ratepayers; and

(3) recovery now ensures that costs are recovered from customers as close as possible to the time period in which customers participated in the DSM programs.

Method for deriving LRAM revenue impact is appropriate

80. The Board should reject APPrO's suggestion that Union's method for deriving the LRAM revenue impact for rate classes M4 and Rate 20 is inappropriate.[74]

81. The rates Union uses for LRAM, in the case of multi-block rates, reflect the single rate block most representative of the DSM-related volume reductions. In the case of Rate M4 and Rate 20, this is the first rate block. Said another way, the vast majority of M4 and Rate 20 consumption that would be impacted by DSM is in the first block. This is different than Rate T1, where the vast majority of consumption impacted by DSM is in the second rate block.

82. Union's practice:

(1) is consistent across all rates classes;

(2) applies to both contract and general service rates;

(3) has been the long-standing Union practice approved by the Board in many cases; and

(4) is the most reasonable proxy of the revenues lost given Union does not track or report DSM-related volume reductions at the rate block level.

Additional Independent Review Unnecessary

83. The scope of the utilities' TEC includes the review of evaluation research priorities and individual studies. Through the TEC process, Union together with its stakeholders, will confirm

[74] APPrO Argument, pp. 6-7

whether a review of the evaluation and verification of its custom portfolio is a priority. SEC's suggestion that an additional independent review be conducted in relation to custom projects therefore is not necessary.

Auditor Availability

84. SEC's comments regarding the availability of the Auditor as a witness is another complaint without substance. That Union received a final audit report from EcoNorthwest is a matter of fact – the report exists, it was reviewed by the EAC and filed with the Board. None of these facts are in dispute. Theys do not change whether a representative of EcoNorthwest testified or not.

85. Union called representatives of the verifications firms and Cascade at SEC's request. Union has never called witnesses from any of these firms as part of its deferral proceedings. It can fairly be surmized that one outcome the Board anticipated from the Generic Proceeding (EB-2006-0021) was that, where, as here, the parties have reached a consensus there would be no need for detailed oral evidence from the various DSM consultants.

86. Ultimately, if SEC had wanted to summons the auditor it could have. Plainly it did not; there is not a single question identified in its argument that it says could not be answered absent the auditor. In any event, Union did explain to SEC that the primary lead for the 2011 audit had left EcoNorthwest.[75] Union determined, as SEC had asked it to do,[76] that a representative from Cascade (who had performed the actual review of Union's custom projects and dealt with the verification consultants) was the appropriate representative.

Other Submissions

87. BOMA, APPrO, CCC and LPMA all made submissions regarding DSM.

88. **BOMA**. BOMA comments on the rigorous review, verification and audit undertaken with respect to the custom DSM projects.[77] In addition, BOMA states, "We cannot assume all

[75] Transcript, Volume 3, pp. 26-27
[76] Cross-examination letter to the Board, September 18, 2013
[77] BOMA Argument, p.10

companies or all energy managers are always deploying best practices when it comes to energy conservation. This is why utility programs like Union's are so valuable".[78] As described above, Union has a key role in influencing customers' decisions when it comes to the implementation of custom projects.

89. **APPrO**. In addition to its comments on LRAM, APPrO questions whether the free ridership rate of 54% should be updated and states its belief that the EUL of a custom DSM project should not automatically be the technical life of the measure.[79] In addition, APPrO submits it has concerns with the method for deriving LRAM revenue in Rate M4 and Rate 20.[80]

90. As Ms. Kulperger testified, the TEC is in the process of scoping out a new free ridership study.[81] Further, as described above, Union does not limit its assessment of EUL to technical life. Union assesses the life for which the savings are planned to persist on a custom basis for each project.

91. **LPMA and CCC**. Both of these parties make the general observation that Union should not claim for savings in relation to projects that customers were going to undertake in any event and that Union has overestimated savings related to custom projects.[82] Union has addressed these concerns above in response to SEC's submissions.

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

92. Board Staff supports the establishment of the new deferral clearing variance account. As it says, the variance account will eliminate risk in the clearance of deferral accounts and will ensure that all parties are held harmless as a result of the disposition process. Board Staff also notes that Union's proposal is consistent with the approach used by Enbridge and electricity distributors.[83]

---

[78] BOMA Argument, p.11
[79] APPrO Argument, p.8, para 18-19
[80] APPrO Argument, pp.6-7
[81] Transcript, Volume 3, p. 140
[82] LPMA Argument, p. 9
[83] Board Staff Argument, p. 15

93. Energy Probe argues that Union should not get "two kicks at the can". Union, it says, should live with the Board-approved dispositions. [84] This is exactly what Union is trying to do. Union's proposal to establish a new deferral clearing variance account allows ratepayers to receive actual, approved deferral balances passed through to them. Union's proposal ensures that neither ratepayers, nor Union, gain or lose on Board-approved dispositions.[85]

94. LPMA, CME and CCC all support the new deferral clearing variance account in principle, but oppose it for 2011 and 2012 on the basis that it was not contemplated as part of the IRM Settlement Agreements. They further argue that under those agreements, Union assumed volume risk.

95. In fact, Union did not decide to take on volume risk on deferral account balances through the IRM plan, as the very purpose of deferral accounts is to eliminate risk by keeping both parties whole. (Union also did not take on any potential volume benefit on the disposition of deferral accounts either.) Union anticipated that any remaining variances at the end of the planned disposition period in question would be immaterial, consistent with what past history would support.[86] Further, Union did not take on the risk that balances would be materially affected by a return of customers from direct purchase to systems sales but that is exactly what happened and what drove, in part, the large over-refund. It was not an error on Union's part. Union cannot anticipate how many customers will return to system supply. This change is outside of Union's control.

96. Finally, Union did not take on the risk that the Board would establish a new deferral account part way through the IRM Framework. In fact, as reflected by the parties' decision to include a "z-factor" it was recognized that unusual circumstances could arise in respect of which Union would not be at risk.[87]

97. For its part, SEC submits that the Board should consider adjusting the terms of an IRM plan only if the result is manifestly unfair, and the proposed adjustment is more consistent with

[84] Energy Probe Argument, p. 16
[85] Union, Argument-in-Chief, p. 24
[86] EB-2012-0087, FRPO, Question 5
[87] EB-2007-0606, Settlement Agreement, Section 6.1

the spirit and intent of the IRM plan. [88] Union is not altering the IRM Framework. The purpose of all deferral and variance accounts is to pass-through items in a manner that is compatible with the principle that neither Union nor its ratepayers should gain or lose on such pass-through items.[89] As Union stated, the variance has not been material in the past. Union has discovered the mechanism does not achieve results that are consistent with the spirit of the IRM under the conditions that were present over the disposition period in question. Therefore, Union requires a new mechanism to achieve what the deferral and variance accounts are intended to achieve. [90]

98. As a final matter, intervenor opposition to the proposed account is (aside from being opportunistic) highly ironic. As the evidence discloses, the over-refund experienced by Union was driven in part by the refund associated with Account 179-130.[91] In arguing for the establishment of that account, intervenors argued that gas costs were a pass-through and that neither Union nor ratepayers should gain or lose on those costs!

F. Audited Financial Statements for Union's Regulated Business

99. On review of the parties' submissions, Union continues to question what incremental information will be available to the Board and to intervenors as a result of the directive. Ultimately, Union agrees that it should be relieved of the directive. Preparation of the statements is costly, time-consuming and will not result in any incremental information. As LPMA notes:

> Union already prepares an earning sharing calculation that is based on the regulated utility earnings. Non-utility activity is taken out of the corporate earnings. Because the earnings sharing calculation requires a regulated utility return on equity, the adjustments made by Union in this calculation are extensive and involve a number of schedules, as evidenced in Exhibit A, Tab 2 of this proceeding. In particular, Appendix A contains numerous schedules based on the regulated utility business. Appendix B shows the adjustments made to the corporate figures to arrive at the regulated utility figures used to calculate the earnings sharing amount." [92]

[88] SEC Argument, p. 32, para. 4.3.2

[89] Transcript, Volume 1, p. 41, lines 7-19

[90] Transcript, Volume 1, p. 41, lines 17-28

[91] Union, Argument-in-Chief, p. 24, para 78

[92] LPMA Argument, p. 8

100. For its part, Board Staff agrees with Union that the information that would be provided in the audited financial statements is not incremental to the information already provided by Union. It submits that this is not the issue. Rather, the issue is the rigour exercised and level of confidence provided in the information that is used in establishing the appropriate allocation between the rate regulated and non-rate regulated storage businesses.[93]

101. As Union stated in its Argument-in-Chief, Union believes that the information currently provided addresses the requirements of the Board and parties in respect of the financial results related to utility operations. Furthermore, the Board has already approved Union's cost methodology for allocating costs between regulated and unregulated. An independent review of Union's cost allocation methodologies was performed by Black and Veatch both in EB-2011-0038 and EB-2013-0365. The purpose of these reports was to exercise rigour and provide confidence in the information used in establishing the appropriate allocation between the rate regulated business and non-rate regulated business.

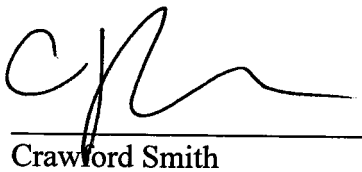
102. Board Staff submits that other options exist that would enhance the robustness of the financial information currently presented by Union. Board Staff presents two options including an assurance provided by an independent professional advisor regarding the required financial information or a segmented note disclosure within Union's consolidated financial statements.[94] Union's opinion on the two options is set out below.

103. **Assurance of required financial information (Earnings sharing calculation).** If the concern is that the Board-approved methodology has been properly implemented and calculated, Union suggests an independent professional provide assurance that the Earnings sharing calculation is in accordance with the Board-approved methodology. This calculation encompasses the removal of non-rate regulated business from both earnings and rate base. Since this information is currently available, the only associated cost would be the independent professional assurance fee.

[93] Board Staff Argument, p. 14
[94] Board Staff Argument, p. 15

104. **Segmented note disclosure within Union's consolidated financial statements.** This option would be similar to the current directive to prepare audited utility financial statements as Union does not currently have the necessary processes and procedures in place to produce segment information. It should also be noted, that in accordance with U.S. Generally Accepted Accounting Principles, Union does not have identifiable segments to report on.

ALL OF WHICH IS RESPECTFULLY SUBMITTED



Crawford Smith
Lawyers for Union Gas Limited