June 13, 2014

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: EB-2013-0365 – Union Gas Limited – 2014 Rates Argument-in-Chief

As per Procedural Order No. 5, please find attached Union's Argument-in-Chief in the above noted proceeding.

Yours truly,

[original signed by]

Chris Ripley
Manager, Regulatory Applications

Cc: EB-2013-0365 Intervenors
Crawford Smith, Torys

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Union Gas Limited

EB-2013-0365

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, pursuant to section 36(1) of the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15 (Schedule. B) for an order or orders approving just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas as of January 1, 2014

ARGUMENT IN CHIEF OF
UNION GAS LIMITED

A. Overview

1. By application dated October 31, 2013, Union Gas Limited ("Union") applied to the Ontario Energy Board pursuant to a Board-approved Incentive Rate Mechanism for an order approving rates for the distribution, transmission and storage or natural gas effective January 1, 2014.

2. A Settlement Conference was held beginning on March 17, 2014. Ultimately, the Conference resulted in a complete settlement of all but two issues: the allocation of Kirkwall Metering Costs and the Leamington Line Project.

3. On May 15, 2014, the Board issued Procedural Order No. 4 providing for an oral hearing in respect of those matters which remained in dispute. In the Procedural Order, the Board further provided that parties wanting to file evidence in relation to the Leamington Line Project should do so by May 27, 2014. Union was the only party to file such evidence. The hearing took place on June 5, 2014.

4. The balance of this argument is addressed to the two issues which are in dispute. It is important to note at the outset, however, that Union is not seeking any relief in relation to either of the disputed issues.

B. The Allocation of Kirkwall Metering Costs

Union's Response to the Board's Directive in EB-2011-0210

5. In EB-2011-0210, Union's 2013 cost of service rebasing proceeding, the Board directed Union to review the allocation of Kirkwall metering costs. For the reasons detailed below, based on that review, Union has not proposed any changes to the allocation of Kirkwall metering costs.[1]

6. Admittedly, the use of the Kirkwall Station has changed over time. In 2012, Union made modifications to its existing Kirkwall metering facilities to allow for bi-directional flow at Kirkwall. These modifications were made in response to changing North American gas supply dynamics and customer requests for new firm transportation services. The modifications to the Kirkwall metering facilities enable gas arriving at Kirkwall to be transported to either Dawn or Parkway on Union's Dawn-Parkway transmission system. The new firm transportation services developed by Union were the C1 Kirkwall to Dawn, M12-X between Dawn, Kirkwall and Parkway and M12/C1 Kirkwall to Parkway transportation services. These services were approved by the Board in EB-2010-0296 and EB-2011-0257, respectively.[2]

7. Union's 2013 Board-approved cost allocation methodology, which allocates Dawn-Parkway Easterly transmission costs, including Kirkwall metering costs, to in-franchise and ex-franchise rate classes is based on a "commodity-kilometres" (distance-weighted demands) allocation. This cost allocation methodology recognizes that the Dawn-Parkway transmission system is designed to meet easterly peak (design) day requirements and that rate classes use the Dawn-Parkway system to varying degrees depending on their design day demands and the distance those design day demands are required to be transported along the Dawn-Parkway transmission system.[3]

8. This cost allocation methodology is appropriate for the costs associated with the Kirkwall Station as it treats these facilities in a manner consistent with other Dawn-Parkway assets and recognizes that these facilities are required to meet easterly peak day demands on the Dawn-

[1] Exhibit A, Tab 1, p. 19
[2] Exhibit A, Tab 1, p. 20
[3] Exhibit A, Tab 1, p. 20

Parkway transmission system. While the Kirkwall Station modifications enable gas arriving at Kirkwall to be transported westerly to Dawn, the facilities are still required on design day to meet easterly peak day demands.[4]

9. The Board has previously recognized that while the Dawn-Parkway transmission system allows for bi-directional flow, the transmission system is designed to meet easterly design day demands. Specifically, in its EBRO 493/494 Decision, the Board approved the commodity-kilometres cost allocation methodology and noted that although the Dawn-Parkway transmission system is "multifunctional and operates as a bidirectional integrated pipeline at other times does not change the fact that on design day both in-franchise and ex-franchise gas is flowing easterly".[5]

10. In accordance with the Board-approved cost allocation methodology, Union's 2013 cost allocation study allocates approximately 84% of the costs associated with the Kirkwall Station to the M12 rate class and the remaining costs to in-franchise rate classes based on their distance-weighted design day demands.[6]

11. In summary, although the Kirkwall Station allows for bidirectional flow, the Kirkwall metering facilities are required to meet easterly demands on the Dawn-Parkway transmission system on design day. Accordingly, the current 2013 Board-approved cost allocation methodology to allocate Kirkwall metering costs to in-franchise and ex-franchise rate classes based on a commodity kilometres basis remains appropriate.

Response to Intervenor Position

12. CME, CCK, FRPO and OGVG have filed evidence prepared by John Rosenkranz. In that evidence, and relevant to these proceedings, Mr. Rosenkranz recommends that Union revise its Board-approved cost allocation study and, resulting M12, Union South and Union North in-franchise rates by:

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[4] Exhibit A, Tab 1, p. 20

[5] Exhibit A, Tab 1, p. 21; EBRO 493/494 Decision with Reasons, March 20, 1997, Section 9.4.31

[6] Exhibit A, Tab 1, p. 21

(1) including all Dawn compression plant and operating and maintenance costs that are assigned or allocated to the Dawn-Parkway system in the Dawn-Trafalgar Easterly functional cost category, and by including all Dawn measuring and regulating (M&R) plant and O&M costs that are assigned or allocated to the Dawn-Parkway system in the Dawn Station functional cost category; and further by,

(2) allocating Kirkwall and Parkway M&R plant and O&M costs to customer classes based on each class's peak demand for firm deliveries to TCPL or Enbridge, and firm receipts from TCPL or Enbridge at the meter station.[7]

13. Of the above recommendations, only the first part of the second recommendation (the allocation of Kirkwall costs) is responsive to the Board's directive in EB-2011-0210. The other recommendations either were (1) not adopted by the Board (i.e., Parkway station cost) or (2) not proposed by Mr. Rosenkranz at all (i.e. Dawn costs) in EB-2011-0210 notwithstanding that he testified in that case in relation to cost allocation matters on behalf of many of the same intervenors that have sponsored his evidence here.[8]

14. Neither of Mr. Rosenkranz's recommendations should be adopted by the Board. For the reasons set out above, it is Union's position that its Board-approved cost allocation methodology best reflects underlying cost causality. Contrary to the Rosenkranz evidence, the proper question is not whether the design of the Kirkwall or Parkway Stations is affected by distance but how those stations are used on design day.[9]

15. Moreover, even accepting that the Rosenkranz recommendations are among a number of possible reasonable alternatives to Union's cost allocation methodology, no compelling reason has been advanced to depart from that methodology. Union is operating under a Board-approved incentive regulation mechanism. Rates are to be adjusted mechanistically. Here, however, intervenors are seeking modest rate adjustments on the basis of what can best be described as a search for a "better mouse trap". This may be appropriate during a rebasing proceeding; it should not be approved here. Notwithstanding Union's view that no change to the Kirkwall

[7] Exhibit K1.3, Rosenkranz Evidence, p.1

[8] EB-2013-0365 Transcript, Volume 1, p. 64; Exhibit K1.5, p. 73 from EB-2011-0210 Decision

[9] Exhibit B9.8

metering costs are required at this time, Union will review the cost allocation and rate design of Dawn-Parkway costs as part of future Dawn-Parkway facilities expansions.

C. The Leamington Line Project

16. This issue asks whether Union's contracting practices with respect to the Leamington Line Project were appropriate. The issue was not raised by Union in its application and would not typically arise in a rate proceeding under the provisions of Union's IRM agreement. Rather, the issue was raised by OGVG. Despite this fact, OGVG elected not to file any evidence relevant to the issue even though it was afforded the opportunity to do so by the Board.

17. As set out in the overview, Union is not seeking any relief in relation to the Leamington Line or any of the M4 or M5A contracts entered into by its customers. It is Union's position that its contracting practices were appropriate and that OGVG's request that customers be "permitted the option of renegotiating" their contracts be dismissed.

The Leamington Line Application (EB-2012-0431)

18. **Background**. By application dated November 23, 2012, Union applied to the Board, pursuant to section 90(1) of the Act for leave to construct approximately 8.5 km of NPS 12 natural gas pipeline in the Municipality of Leamington, and the Town of Lakeshore in the County of Essex (the Leamington Line). Union's application and supporting evidence in EB-2012-0431 (the "Application") have been filed by Union in this proceeding.[10]

19. OGVG did not intervene in the Application, nor did any of the other intervenors that cross-examined in this proceeding.

20. As with other leave to construct applications, the Application considered the need for the project, as well as project economics.[11] In relation to these issues, Union advised as follows.

21. *Need*. The Application was in response to requests for additional natural gas service from greenhouse growers in the Leamington area. As Union set out in the Application:

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[10] Exhibit A, Tab 6, p. 1; Exhibit A, Tab 6, Appendix A

[11] Exhibit A, Tab 6, pp. 1-2; Exhibit A, Tab 6, Appendix A

> Union has received a number of requests for firm and interruptible natural gas service from greenhouse growers in the Leamington, Kingsville, Mersea Township and Gosfield South Township area.
>
> These requests have come from new greenhouse operations, greenhouses that operate on fuels other than natural gas, and from growers who want to switch from interruptible service to firm natural gas service.[12]

22. In order to determine more precisely the level of interest in natural gas service, Union held an open season (issued an "Expression of Interest"). Among other things, the open season advised prospective customers that:

(1) the Leamington Line would provide additional capacity to serve an equivalent of 509 acres of greenhouses in the Leamington and Kingsville area;

(2) development of the Line was contingent on sufficient market support and approval by the Board;

(3) as the Line required a significant capital investment, Union would require a minimum contractual commitment of one year and/or an upfront payment for capacity and that this contract would have to be signed following approval of the Line from the Board;

(4) the expected cost per acre that would be attributed to the customers requesting service would be $10,300 per acre for interruptible service and $20,500 per acre for firm service which costs did not include the individual customer specific costs that are required to serve customers such as station costs, customer service lateral costs; and that,

(5) capacity would be awarded on a first come, first serve basis.[13]

23. *Project Economics*. The open season was well-received and provided Union with an understanding of the potential growth in the greenhouse market in the area. Union used the results of the open season to prepare its forecast of loads and costs.[14]

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[12] Exhibit A, Tab 6, Appendix A

[13] Exhibit A, Tab 6, Appendix A

[14] Exhibit A, Tab 6, pp. 1-2; Exhibit A, Tab 6, Appendix A

24. Based on these forecasts, Union prepared a discounted cash flow ("DCF") analysis pursuant to the Board's E.B.O. 188 Guidelines. Union's revenue forecast was based on 10 years of gas use from the customer group from the date of attachment (which itself was forecast to take place over three years). The economics of the Leamington Line were based on recovering the cost of the Line by allocating the cost to each acre of new greenhouse gas load.[15]

25. As initially filed, the revenue forecast for the 10 year period and the forecasted costs resulted in a profitability index ("PI") of less than 1.0. The evidence determined an aid to construct of $2.092 million would be needed for a PI of 1.0. However, during the argument phase, Union updated its DCF analysis to reflect changes in forecast costs associated with the Leamington Line and updated information with respect to the timing of attachments and the relative portion of those attachments which were anticipated to request firm, as opposed to interruptible, service. While the 10 year revenue term did not change, the changes which were made resulted in an updated PI for the Leamington Line of 1.18. Union filed its updated DCF analysis with its reply submission and argued that:

> With this updated information Union respectively submits that the Board Staff submission that the $2 Million contribution from the greenhouse growers be collected prior to the start of construction is no longer applicable.[16]

26. **Board Approval**. The Board granted Union leave to construct the Leamington Line on March 28, 2013. In its Decision, the Board:

(1) referred to Union's evidence regarding the source of the requests for service (i.e, new and existing greenhouse operators), recognized that Union had entered into contractual negotiations with a number of these prospective customers, that this would continue until the pipeline was at full capacity and found that Union had "adequately substantiated the need for the Proposed Pipeline"; and,

(2) reviewed the economics of the Leamington Line set out above concluding that the Board, "accepts Union's evidence on the cost estimates and will not require

[15] Exhibit A, Tab 6, pp. 1-2; Exhibit A, Tab 6, Appendix A
[16] Exhibit A, Tab 6, pp. 2-3; Exhibit A, Tab 6, Appendix A

> Union to collect a contribution from greenhouse growers prior to constructing the Proposed Pipeline."[17]

Contracting on the Leamington Line

27. Subsequent to receiving approval from Board, Union continued the contracting process.

28. Union did not require an upfront aid to construct the Leamington Line. However, as described below, in order to ensure that the forecast of revenues which underpinned the DCF analysis submitted to the Board would be met, Union did require a contractual revenue commitment from its customers. Absent such a commitment, Union and other ratepayers would be at risk if customers did not attach to the Leamington Line or did not consume gas as forecast.[18]

29. For each customer, Union compared the cost to serve that customer relative to the revenues that would be received over 10 years. With respect to the costs, these were a combination of (1) customer site specific costs and (2) a proportionate share of the cost of the Leamington Line. With respect to revenues, these were a function of the relevant Board approved rate for service multiplied by 10 years of consumption at a level determined by the customer – the customer's Minimum Annual Volume (the "MAV"). In the event the PI for the customer was greater than 1.0, Union calculated the minimum number of years required for a PI of 1.0 and advised the customer. Typically, customers selected the shortest term possible that achieved a PI of 1.0.[19] As Mr. Hockin described the process:

> MR. HOCKIN: The revenue for any particular customer is based upon the ten-year revenue stream. You get to a six-year term because the total cost for that particular customer, the allocated cost of the transmission line, plus the site-specific distribution costs, with a revenue term of ten years, results in a PI of something more than 1.
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> Back-calculating on behalf of the customer, how far back -- how short a term does a customer need to contract for in order to get to a PI of 1, and then the sample contract, six years would have got them to a PI of 1.

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[17] Exhibit A, Tab 6, Appendix D

[18] Exhibit A, Tab 6, pp. 4-5; EB-2013-0365 Transcript, Volume 1, p. 146

[19] Exhibit A, Tab 6, pp. 4-6

> So we didn't do a DCF based upon a six-year term. We did a DCF based upon a ten-year term, and that particular customer has a PI greater than 1, with a minimum ten-year forecasted revenue stream. They're only contracted at a contractual basis to perform for six years underneath the MAV contract for the parameters that were used in that particular circumstance.[20]

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> MR. HOCKIN: Yes. The principle of what's behind the calculation is, there's an investment required, and we're simply trying to contract a term that underpins the revenue term associated with the investment decision.[21]

30. Ultimately the terms of the Leamington contracts were the result of discussions between Union and each one of its customers. As Ms. Caille further explained[22]:

> MS. CAILLE: I wouldn't phrase it that way, so I would have agreed with you when you said they're negotiated. We present the customer with the -- what we started with as the shell, speaking earlier, Exhibit -- pardon me -- K16 -- 1.6, and discuss with the customer what their volume will be, what they want to anticipate to use, in order to determine what the contract parameters would be.
>
> So there are discussions back and forth around the parameters in order to negotiate the contract terms. We don't impose --
>
> MR. SHEPHERD: Okay. Well -- so let me ask a couple of --
>
> MS. CAILLE: -- the volume --

31. The Leamington Line is now fully subscribed.

> MS. CAILLE: We currently have 419.8 acres already under contracts with customers that have signatures. And then the remaining customers – the remaining acres available are in discussions with active customers that had expressed interest and were going on a first-come, first-served basis to get capacity.[23]

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[20] EB-2013-0365 Transcript, Volume 1, pp. 102-103

[21] EB-2013-0365 Transcript, Volume 1, p. 104

[22] EB-2013-0365 Transcript, Volume 1, pp. 131-132

[23] EB-2013-0365 Transcript, Volume 1, pp.153-154

Response to OGVG

32. On two separate occasions during the hearing, OGVG was asked to set out the relief it would be seeking from the Board. On both occasions it failed.[24] Only by letter dated June 9 did OGVG made its position clear. In that letter, OGVG advises that it will be asking the Board to relieve customers of their contractual commitments to Union and permit them to renegotiate their contracts. OGVG says that this renegotiation should be “absent recognition of any …allocation” of the total cost of the Leamington Line.[25]

33. OGVG says that the primary basis for its request is that it was inappropriate for Union, having advised the Board in its reply argument that an aid to construct was unnecessary, to have negotiated contracts for service which included a commitment to a minimum annual volume over a period of time or an aid to construct if the customer preferred a shorter contractual term.

34. It is Union’s position that OGVG’s request should be denied. First, its argument completely misunderstands the aid which was described, and at issue in EB-2012-0431.

35. As described above, as initially calculated, the Leamington Line had a PI of 1.0 only on the <u>combination</u> of (1) the 10 year forecast of revenues, and (2) an aid to construct of approximately $2.1 million funded by all prospective customers. When it re-calculated the DCF based on its revised revenue forecast, Union advised the Board that item (2), the aid to construct was no longer required. At no point did Union ever advise that the Leamington Line had a PI of 1.0, or was otherwise profitable, if its revenue forecast (item (1)) was not met. On the contrary, Union advised of exactly the opposite: assuming the forecast revenues could be achieved the Leamington Line had a PI of 1.18.

36. In substance, the only thing Union did through its contracting in connection with the Line was make good on the forecast it had provided to the Board and which formed the basis for the Board’s decision. In other words, Union acted entirely appropriately, in a manner which was consistent with the evidence and argument it had filed.

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[24] EB-2013-0365 Transcript, Volume 1, p. 105 and p.142
[25] Letter on behalf of OGVG dated June 9, 2014

37. Second, even if OGVG were correct with respect to its interpretation of Union's reply submission (which is denied), its position lacks logical force. OGVG is seeking contractual relief not on the basis of a representation that was made to it but rather to a third party (the Board). Having decided not to intervene in the prior proceeding or to file any evidence as to its own expectations, this position is without merit. Moreover, the position is inconsistent with the open season OGVG members overwhelming responded to positively which contemplated a possible aid to construct.

38. OGVG also makes the following secondary arguments in support of its position, each of which is rejected by Union.

39. First, it refers to provisions of the Gas Distribution Access Rule to suggest that Union failed to act in a non-discriminatory manner.[26] The evidence, however, is that capacity was allocated on a first come, first serve basis. No customers were discriminated against.

40. Second, it complains that the full cost of the Leamington Line should not have been allocated to greenhouse growers.[27] This argument ignores completely the fact that the basis for the project was their request for service. Put simply, the Leamington Line was built to serve their demands, and only their demands. As Ms. Caille testified:

> [W]e looked at how many customers have attached over the last year in relation to greenhouse growers. And I wrote it down; it's a quarter of a percent of the capacity went to homes or other businesses. So of that 509 acres that was built for the greenhouse growers, only the equivalent of 1.5 acres was consumed by anybody else.
>
> It was -- it was built because they were asking us to provide more capacity to that area.[28]

41. It is entirely appropriate that the customers that caused the system to expand, and that benefit from that expansion should pay for it. This is the approach that Union has taken across its system for years.

[26] Letter on behalf of OGVG dated June 9, 2014

[27] Letter on behalf of OGVG dated June 9, 2014

[28] EB-2013-0365 Transcript, Volume 1, p.136

42. Finally, OGVG argues that Union should have allocated costs to customers more precisely based on their actual load requirements.[29] In fact, as set out above, Union did consider customer specific loads in negotiating the terms of the contracts.

Response to Board Staff

43. In cross-examination Board Staff asked for Union's position as to whether the Board has jurisdiction to vary the terms of the Leamington Line contracts.[30] In Union's view, the Board does not need to resolve that question in order to dismiss OGVG's request for relief. For the reasons set out above, that request is without merit. In any event, while the Board, under its rate-making power, undoubtedly has the jurisdiction to vary the amount paid by M4 and M5A customers for service, Union doubts whether that jurisdiction goes so far as to permit the Board to relieve customers entirely of their contractual commitments, as OGVG's request appears to contemplate.

Conclusion regarding the Leamington Line

44. The approach taken by Union in relation to contracting for the Leamington Line was appropriate. Further, it was consistent with the approach taken by Union in connection with other distribution facility expansions and the Board's E.B.O. 188 Guidelines. The MAV chosen by the customer is a contractual commitment to the revenue forecast that underpins the economics of the Leamington Line. The contractual commitment is consistent with the customer's request for service through the open season process. Absent a contractual commitment by these customers, Union would not have constructed the Leamington Line.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

[Original signed by]

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Crawford Smith
Lawyers for Union Gas Limited

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[29] Letter on behalf of OGVG dated June 9, 2014
[30] EB-2013-0365 Transcript, Volume 1, p. 161