July 4, 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 – Reply Argument

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

Should you have any questions, please contact me at 519-436-5476.

Yours truly,

[Original Signed by]

Chris Ripley
Manager, Regulatory Applications

cc: Crawford Smith (Torys)
EB-2013-0365 Intervenors

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

REPLY ARGUMENT OF UNION GAS LIMITED

A. Overview

1. This is Union Gas Limited's Reply Argument in EB-2013-0365. 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 none of the relief requested in relation to the two disputed issues — the allocation of Kirkwall metering costs and the Leamington Line Project — should be granted by the Board.

2. The balance of this argument is addressed to these issues and follows the organization of Union's Argument-in-Chief.

B. The Allocation of Kirkwall Metering Costs

3. APPrO, Board Staff, BOMA, CCC, CME, Energy Probe, FRPO, Kitchener, and LPMA all filed argument in relation to this issue.[1]

4. In general, those parties that advocate for a change to Union's Board-approved cost allocation methodology[2] argue that because the use of the Kirkwall Station has changed over

[1] OGVG's argument supported FRPO and CME's position.
[2] APPrO, BOMA, CME, FRPO, Kitchener.

time, the allocation of metering costs at the Station should be changed as well. Board Staff, CCC, Energy Probe and LPMA oppose the requested relief. Those parties recognize that even if a change to that methodology were warranted, the amount at issue is immaterial and any change should not be made until Union's next rebasing proceeding.

5. Union's position remains that it has responded appropriately to the Board's Directive in EB-2011-0210 to review the allocation of Kirkwall metering costs and that the current methodology, which allocates those costs to in-franchise and ex-franchise rate classes based on a commodity kilometers (distance-weighted demands) basis, is appropriate.

Kirkwall Metering Costs Are The Only Costs at Issue

6. To begin, it is important to delineate what is, and what is not in issue.

7. In his evidence, Mr. Rosenkranz makes five recommendations. As described in Union's Argument-in-Chief, and as admitted by CME, only two of those recommendations are potentially relevant to this proceeding.[3] They are set out at paragraph 27 of Union's Argument-in-Chief. In brief, the first recommendation relates to Dawn compression and measuring and regulating ("M&R") plant and operating and maintenance ("O&M") costs, while the second relates to Kirkwall Station and Parkway Station M&R plant and O&M costs.

8. CME argues that both recommendations should be adopted by the Board. However, only the first part of the second recommendation (the allocation of Kirkwall costs) is relevant to Union's response to the Board's Directive. Further, it is the only recommendation covered by the Settlement Agreement entered into by the parties (including CME) and approved by the Board. That agreement provides, in relevant part:

> "**10.5 Undertake a Review of the Allocation of Kirkwall Metering Costs.** In its EB-2011-0210 Decision, the Board directed Union to review the allocation of Kirkwall metering costs. The parties agree that this issue will proceed to hearing before the Board for determination. In order to implement rates on June 1, 2014, the parties agree that any

[3] EB-2013-0365, Transcript, Volume 1, p. 58.

cost allocation changes to the Kirkwall metering costs as a result of the Board's Decision will be implemented January 1, 2015 as part of Union's 2015 rates proceeding."

9. Contrary to CME's argument at paragraph 6, the Board did not "direct" Union in EB-2011-0210 to review the allocation of Parkway Station costs in this proceeding. It also did not consider Union's response to the Directive in EB-2011-0257, "to be incomplete" as CME boldly asserts. The Board, in EB-2011-0210, after rejecting Mr. Rosenkranz's recommendations noted that the outcome of the Parkway Working Group could have an impact on the proper allocation of Parkway Station costs.[4] As matters have unfolded, however, the result of that working group (i.e. the Parkway Delivery Obligation settlement) has no impact on the proper allocation of Parkway Station costs.[5]

10. In the result, the proper conclusion with respect to Mr. Rosenkranz's non-Kirkwall related cost recommendations is that they were (1) not adopted by the Board in EB-2011-0210 (i.e. Parkway Station costs) or (2) not proposed by Mr. Rosenkranz at all (i.e. Dawn costs). In either case, they are not properly before the Board and should not be considered now as part of this proceeding.

Response to Intervenor Position

11. Intervenors that argue for a change to Union's Board-approved cost allocation methodology point to the change in North American gas supply dynamics and the resulting impact on the use of the Kirkwall Station. This argument is addressed at paragraphs 5 to 11 of Union's Argument-in-Chief. For the reasons set out there, these changes do not warrant a change to the cost allocation methodology.

12. Union's cost allocation methodology recognizes that the Dawn-Parkway transmission system (including the Kirkwall station) is designed to meet easterly peak (design) day requirements and that rate classes use the Dawn-Parkway system to varying degrees depending

[4] EB-2013-0365, Exhibit K1.5.

[5] EB-2013-0365, Transcript, Volume 1, pp. 65-66.

on their design day demands and the distance those design day demands are required to be transported along the Dawn-Parkway transmission system.[6]

13. The Board approved Union's current methodology in EBRO 493/494. The Board did so while noting that the Dawn-Parkway system is bidirectional. As the Board specifically held, 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".[7]

14. This statement by the Board applies with equal force to the allocation of Kirkwall Station costs. These facilities are part of Union's integrated transmission system. From a cost allocation perspective, they should be treated in a manner consistent with other Dawn-Parkway assets. While the Kirkwall Station modifications enable gas arriving at Kirkwall to be transported westerly to Dawn (that, is bidirectionally), the facilities are still required on a design day to meet easterly peak day demands.[8]

15. Contrary to the Rosenkranz evidence and intervenor argument, 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]

16. It is also wrong to suggest, as CME does, that the result of Union's Board-approved cost allocation methodology is "inappropriate". In Union's view, its methodology best reflects principles of cost causality. But, in any event, the most that could be said is that there is a reasonable disagreement between the parties (over a very modest level of costs) (see Union's Argument-in-Chief at para. 15).

17. Ultimately, no compelling reason has been advanced to depart from Union's Board-approved cost allocation methodology. Rates under incentive regulation should be adjusted mechanistically rather than through continuous refinement of the cost allocation process. Here, in particular, the costs impacts are immaterial. The impact of Mr. Rosenkranz's recommendation

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[6] Exhibit A, Tab 1, p. 20.
[7] Exhibit A, Tab 1, p. 21; EBRO 493/494 Decision with Reasons, March 20, 1997, Section 9.4.31.
[8] Exhibit A, Tab 1, p. 20.
[9] Exhibit B9.8.

relating to Kirkwall costs is approximately $217,000. As noted by Board Staff, CCC, Energy Probe, and LPMA, these impacts do not warrant a change to the cost allocation methodology.

18. In Union's view, even if the Board were to agree with Mr. Rosenkranz, the cost shift should not occur until Union's next rebasing proceeding.

C. The Leamington Line Project

19. It remains Union's position that is contracting practices were appropriate, consistent with the approach taken by Union in connection with other distribution facility expansions and the Board's E.B.O. 188 Guidelines.

20. IGUA, Energy Probe and LPMA all support Union's position. As LPMA notes in its submission:

> "It appears that the OGVG request is based on the belief that because no aid to construction was required from the greenhouse growers for the Leamington Line, they should not be required to commit to the contractual requirements to which they agreed.
>
> LPMA submits that the OGVG proposal would result in other customers paying for the costs associated with the Leamington Line, rather than the customers for which the line was built. This subsidization is not appropriate.
>
> The OGVG approach undermines the EBO 188 approach that ensures that customers that create the demand for additional investments pay for it, rather than having existing customers subsidize new customers.
>
> Union's approach to recovering the costs from contract customers through the terms of the contract (term, MAV, CD) is not a new concept, nor is it unique to Union…."[10]

21. Union agrees with LPMA's submission.

[10] LPMA Submission p. 4.

Response to OGVG and others

22. The relief claimed by OGVG is set out at page 3 of its argument. It represents OGVG's fourth articulation of its claim and it is different than the claim set out in its letter dated June 9, 2014.

23. OGVG now claims that the Board should "reduce the annual MAV requirements in accordance with the customer's actual gas needs and reintroduce the ability of the customer to terminate their contract on "normal terms at the customer's option". In the alternative, OGVG asks that the Board "set aside the MAV requirements of these contracts as unenforceable given that they constitute a rate that was not approved by the Board". None of these claims should be granted by the Board; they are all without merit.

24. OGVG makes two main arguments in support of its claimed relief. First, OGVG repeats its assertion 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. Second, OGVG (and others)[11] argues that the contractual minimum annual volume ("MAV") requirements constitute a rate, not approved by the Board which, OGVG says, makes the contracts void.

25. OGVG's first argument is comprehensively dealt with at paragraphs 33 to 37 of Union's Argument-in-Chief. OGVG has failed entirely to address these paragraphs. In substance, OGVG's argument repeats its misunderstanding of the aid which was described and at issue in EB-2012-0431.

26. The aid to construct initially contemplated in EB-2012-0431 was not charged by Union, nor reflected in the terms of any customer contract. The volume commitments (i.e. the MAVs) agreed to by customers in their contracts with Union are at levels chosen by those customers having regard to their own business operations. The MAVs reflect a commitment to consume a given quantity of gas for a period of time (on average 7 years) at the Board-approved M4 or M5A rate. There is no increased cost of service associated with the MAVs. There is nothing

[11] BOMA, SEC and Energy Probe.

new or unique about this form of multi-year commitment; Union has taken the same approach to contracting across its system for years. It is also entirely appropriate to ensure that the well-defined group of customers that caused the system to expand, and which benefit from that expansion, pay for it.[12]

27. The aid contemplated in EB-2012-0431 on the other hand was an incremental cost, in addition to the M4 or M5A rate to be charged, in circumstances where the PI for the Project was (then) anticipated to be less than 1.0. IGUA's submission properly characterizes the distinction between the volume commitments made by customers and the aid to construct which was initially at issue:

> "1. An aid to construct is required when the Profitability Index (PI) for an expansion is less than 1 (that is, when the forecast revenues from the services provided by the expansion fall short of the forecast costs of the expansion, all as calculated in accord with EBO-188 guidelines). In this instance, Union will require an upfront contribution from customers for whom the expansion is to be constructed which will bring the PI to 1.0. The forecast revenue from the expansion is then collected, in the normal course, in payment of the services provide by the expansion over time.
>
> 2. In the Leamington expansion case, the PI was greater than 1.0. The contracts required by Union from the greenhouse growers for whom Union says the expansion was built were designed to provide assurance that the forecast revenues underpinning the PI calculations were in fact realized."[13]

28. Union further agrees with IGUA's observation that, "contracting to secure such revenue [the revenue forecasted as part of an expansion] should be designed to protect other ratepayers from subsidizing the expansion."[14]

29. With respect to OGVG's second argument relating to prior Board approval, it similarly lacks merit.

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[12] At pages 3 and 4 of its argument, OGVG purports to suggest that customers only "ostensibly" accessed the capacity arising from the Project. The evidence, as set out in Union's Argument-in-Chief, is that the Leamington Line was built to serve these customers and only these customers (for e.g. see para. 40): the equivalent of 509 acres of capacity was added by the Project with only 1.5 acres taken by anyone other than greenhouse growers.

[13] IGUA Submission pp. 1-2.

[14] IGUA Submission p. 2.

30. Union has never asked for pre-approval of the terms of distribution contracts to be entered into following a leave to construct application. E.B.O. 188 does not contemplate such such approval. Indeed, quite apart from a leave to construct situation, Union has never sought, nor has the Board required, pre-approval of the form or executed version of Union's contracts with its in-franchise distribution contract customers notwithstanding that there are hundreds of such customers.

31. Moreover, Union is, in fact, charging the customers the Board-approved rates for service. As evident from Exhibit K1.7, the applicable M4 and M5A rate schedules are incorporated by reference into the contracts at issue and are the rates being charged. These rate schedules also specifically contemplate the possibility of parties entering into multi-year contracts. Indeed, as CME says in its submission, "Union was free to ask customers to sign contracts to take service for periods longer than a year but the price for distribution services to be provided…has to be in accordance with Board approved rates".[15] That is precisely what Union did.

32. Finally, it was well known to the Board and intervenors at the time of the leave to construct proceeding that Union was still in negotiations with potential customers. In this respect, and as set out in Union's Argument-in-Chief, the Board noted in its Decision that Union was in negotiations with a number of prospective customers and that this would continue until the pipeline was at full capacity.

33. In support of this second argument (and elsewhere) OGVG also suggests that the terms of the contracts do not reflect actual customer usage. There is absolutely no evidentiary basis for this suggestion. On the contrary, the reasonable inference to be drawn from OGVG's failure to adduce any evidence (or even to ask Union for information relating to usage) is that customer consumption reflects the terms of their contracts. Moreover, and as set out above and in Union's Argument-in-Chief, customers were consulted with respect to the terms of their contracts and they chose their own volume levels.

[15] CME Submission para. 34.

34. Equally wrong is the suggestion that the contracts have any negative impact on future DSM or energy efficiency initiatives. Plainly, customers are in the best position to make the assessment of whether they intend, over the term of the contract, to invest in energy efficiency initiatives. To the extent they intend to do so, this will form part of their own assessment of the volume commitment they are prepared to make to Union.

35. **No relevant "Additional Considerations"**. Under this heading OGVG asserts that two additional considerations are relevant to its claim. First, it says that the Board should consider the "genesis of the issue" and communications between Union and OGVG. Second, it asserts that there is no material risk to Union or ratepayers that "warrant multi-year commitments to MAVs" from customers. Union rejects each of these assertions.

36. With respect to the first assertion, OGVG focuses exclusively on communications up to July 18, 2013. OGVG ignores entirely the further exchanges of correspondence between the parties through August, November and December, 2013. Whatever may have been OGVG's level of misunderstanding up to July, it cannot seriously be argued that there was any confusion after that date.

37. With respect to the second assertion, contrary to OGVG's argument, the E.B.O. 188 Guidelines do not provide that the revenue forecast for large volume customers shall be 20 years. Rather, they provide that the revenue forecast shall be a <u>maximum</u> of 20 years. Here, Union's revenue forecast was based on 10 years of gas use. This is the period of time commonly used by Union. Moreover, no party objected to the length of the forecast in the leave to construct proceeding and it was specifically noted by the Board in its Decision approving the Project.

38. Further, even if the forecast revenue period in the DCF analysis were longer that would not obviate Union's need to secure from customers a contractual commitment to revenues over that period. Put differently, regardless of whether the forecast period was 10 years or 20 if there was no commitment to consume gas by customers (through the contracting process) then the risk of a revenue shortfall would fall, inappropriately, on others. Relevant in this respect, and as evidenced by the number of interruptible customers, is the fact many of the greenhouse growers have access to alternative fuel sources (i.e. oil). In the result, absent a contractual commitment from the customers — who caused the system to expand — they could decide when, and if, they

wanted to consume gas with the risk and impact of a failure to consume being borne by Union and other customers. In this context, the fact that there may be a waiting list for capacity is irrelevant given the fact that there is no reason to believe that all customers (existing and potential) are not similarly situated with respect to the ability to fuel switch and would have the same economic incentive to do so.

No Basis for Future Relief

39. Beginning at page 10 of its argument, OGVG appears to argue that the Board should issue guidance or direction with respect to the form of any future leave to construct application in the Leamington area. In Union's submission, there is no proper basis for OGVG's request.

40. In large measure OGVG's submissions for future relief suffer from the same failings as its earlier submissions. For example, its argument under "allocation of costs" repeats its suggestion that the terms of individual contracts do not reflect customer specific costs and load forecasts. As set out above, this is simply wrong. So too is the reference to the assumption used by Union to forecast volumes as part of its DCF analysis (125 m^3/hr per acre for conversion customers and 100 m^3/hr per acre for new customers). These figures were not used in the determination of volume commitments made by customers. They were used as part of the DCF analysis in the leave to construct application to determine a unitized cost of the Leamington Line, and there is no evidence that these assumptions were unreasonable. Finally, by way of example, also incorrect are OGVG's comments relating to "load forecasting" which, again, are premised on its misunderstanding of the aid to construct initially contemplated in the leave to construct and which was not charged.

41. In any event, even if OGVG's assertions had any merit (which is denied), the Board should not grant the future relief OGVG is seeking. Union has not filed an application for leave to construct in the area, may never do so, and the Board should not make any decisions until it has a full evidentiary record against which to assess that application. In this respect, if Union were to file an application it would be open to OGVG to intervene in that application, ask interrogatories in relation to the application, file evidence of its own and, ultimately, make whatever arguments it determines were appropriate based on the final record.

42. Finally, in Union's submission, it is important to put OGVG's complaints here in the broader regulatory context. E.B.O. 188 was issued by the Board nearly 20 years ago. This is the first case in which complaints of the type raised by OGVG have been made against Union or its contracting practices.

Conclusion regarding the Leamington Line

43. From a commercial perspective, now that the Leamington Line has been built and is in service, it is entirely rational that OGVG members would like to be relieved of their contractual commitments to Union. They should not be.

44. The approach taken by Union in relation to contracting 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. As the evidence reflects, the MAV chosen by the customer is a contractual commitment to the revenue forecast that underpins the economics of the Leamington Line. The commitment is consistent with the customer's request for service through the open season process. It properly ensures that the customers that caused the system to expand and which benefit from that expansion properly pay for it.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

[original signed by]

Crawford Smith
Lawyers for Union Gas Limited