Ontario

ONTARIO ENERGY BOARD

BOARD STAFF SUBMISSION

ON UNSETTLED ISSUES

UNION GAS 2014 IRM RATES

Board File No. EB-2013-0365

June 20, 2014

Introduction

Union Gas Limited ("Union") filed an application on October 31, 2013 with the Ontario Energy Board (the "Board") pursuant to section 36 of the *Ontario Energy Board Act, 1998*, S.O. c.15, Schedule B, for an order or orders approving rates for the distribution, transmission and storage of natural gas, effective January 1, 2014.

Union's application for 2014 rates was based on an Incentive Ratemaking Mechanism ("IRM") approved by the Board in EB-2013-0202. The Board issued a Notice of Application and Hearing on November 22, 2013. In Procedural Order #1 issued on December 20, 2013, the Board made provision for interrogatories, for intervenors to file evidence and scheduled a settlement conference with the objective of reaching a settlement among the parties on the issues.

Union filed a Settlement Agreement and Draft Rate Order on April 24, 2014. Union and the parties reached a settlement on all issues with the exception of three issues:

1. Parkway Delivery Obligation;
2. Allocation of Kirkwall Metering Costs; and
3. Leamington Line Project.

On June 3, 2014 Union filed an update to the Settlement Agreement which included a settlement on the Parkway Delivery Obligation. Union presented the Parkway Delivery Obligation settlement at the oral hearing. The hearing also dealt with the two remaining unsettled issues.

The submissions below reflect observations and concerns of Board staff on issues that remain unsettled in this proceeding:

- Allocation of Kirkwall Metering Costs; and
- Leamington Line Project.

Allocation of Kirkwall Metering Costs

In Union's 2013 rebasing proceeding (EB-2011-0210), the Board directed Union to review the allocation of Kirkwall metering costs. The Board in its Decision noted that the use of the Kirkwall Station had changed substantially over the years and that there was a need to review the allocation of Kirkwall Station costs. Accordingly, the Board directed Union to undertake a review of Kirkwall Station costs as part of the updated cost allocation study to be filed in the 2014 rates application[1].

The Kirkwall Station is an interconnection between Union Gas and TransCanada Pipelines Limited ("TCPL") located on Union's Dawn-Parkway transmission line. The Kirkwall interconnect has been historically used to export gas to the US at Niagara and Chippawa.

Union's current cost allocation methodology is based on the assumption that the Dawn-Parkway transmission system is designed to meet easterly peak day requirements. In 2012, Union made modifications to the existing Kirkwall metering facilities that facilitated bi-directional flow at Kirkwall. The changes allowed Union to accept gas from TCPL at the Kirkwall interconnect and transport the gas to Dawn or Parkway. These modifications were made in response to changing North American gas supply dynamics that allowed Union to access gas from the United States. The modifications to the Kirkwall Station allowed Union to not only export gas but also receive gas. The new service was used by M12 shippers to move gas from Kirkwall to Parkway or Dawn.

Union in this application has indicated that it has reviewed the cost allocation methodology and proposes no changes to the existing allocation. Union's argument is that its current 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-Parkway transmission system. In other words, Union is not proposing to allocate costs based on the bi-directional flow through Kirkwall.

In its Argument-in-Chief, Union referred to the EBRO 493/494 Board Decision that approved Union's cost allocated methodology and noted that although the Dawn-Parkway transmission operates on a bi-directional basis, it does not change the fact that on design day, both in-franchise and ex-franchise gas flows easterly[2]. Board staff however notes that the Board's Decision in EBRO 493/494 was rendered in 1997 and

[1] Board Decision EB-2011-0210, October 25, 2012, Pg.74
[2] Decision With Reasons, EBRO 493/494, March 20, 1997, Section 9.4.31

Union itself has noted that the gas supply dynamics have changed significantly in recent years. As a result, Board staff submits that the cost allocation methodology that seemed appropriate before may not be considered suitable under a vastly different gas supply environment. In fact, a number of proposed pipeline projects[3] of Union are predicated on the fact that new sources of supply are available in the south and should be tapped into for providing greater reliability and a diverse supply portfolio.

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[4]. In response to an interrogatory from Board staff, Union indicated that if Kirkwall Station costs were to be allocated on a bi-directional basis, 98% of the costs would be allocated to the M12 rate class and 2% would be allocated to Union South in-franchise rate classes[5].

Using the Board approved cost base of $1.57 million, the shift in costs for in-franchise customers works out to $217,200 ($251,200 - $34,000). This means that in-franchise customers would be allocated a lower amount, $34,000, versus the current allocation of $251,200.

Exhibit B1.3 (response to Board staff interrogatory) indicates that approximately 35% of the volumes flow in the reverse direction (from Kirkwall to Dawn/Parkway) through the Kirkwall Station. The volumes are significant and there are definitely certain costs associated with moving those volumes. However, Union does not allocate any costs to the reverse flow volumes based on its design day cost allocation methodology. From a cost causality standpoint, Board staff is of the view that the cost allocation methodology should reflect the bi-directional flow of the Kirkwall metering facilities.

The next issue is whether a change to the allocation methodology is warranted in the current IRM proceeding. The IRM framework delineates costs from revenues and rates are adjusted annually using a formulaic adjustment during the IRM plan term. There are no provisions for such rate adjustments under the Board-approved 2014-18 IRM framework for Union. Changes to a cost allocation methodology are also generally dealt with at the time of rebasing, not during the IRM plan term. The adjustment is also

[3] Parkway West and Brantford-Kirkwall Projects (EB-2012-0433 and EB-2013-0074)
[4] Exhibit A, Tab 1, Pg.21
[5] Exhibit B1.3, Pg.2

de minimus. The cost shift from in-franchise customers (i.e. $217,200) represents about 0.03% of Union's total revenue for in-franchise customers[6]. Similarly, the cost benefit to M12/C1 customers under the existing allocations constitutes 0.1% of 2013 M12/C1 revenues[7].

Accordingly, Board staff submits that no change to the cost allocation methodology be required. The Board in EB-2011-0210 was aware that Union would be under an IRM framework when it ordered Union to review the Kirkwall Station costs. However, the impact of such a review was not known and the review was ordered as part of a general update to the cost allocation study.

Board staff agrees with Union's position that such adjustments should be reviewed during a rebasing proceeding. Board staff submits that Union should be required at the next rebasing to consider whether all Dawn-Parkway transmission assets should be allocated on a design day basis or whether certain assets should be allocated in a different manner.

Leamington Line Project

The Leamington Line Project issue was not part of Union's pre-filed evidence. As part of the Settlement Agreement, Union agreed with Ontario Greenhouse Vegetable Growers ("OGVG") to add the issue to the proceeding.

In November 2012, Union applied for leave to construct a natural gas pipeline in southern Ontario to meet growing demand from greenhouse growers. Union in its application determined that it needed an aid to construct as the revenue forecast for the ten year period and the forecasted costs resulted in a profitability index ("PI") lower than 1.0.

In response to a submission from Board staff, Union updated its discounted cash flow ("DCF") analysis and indicated that it did not require an aid-to-construct based on the

[6] Total 2013 in-franchise revenue requirement of $856.2 million as per EB-2013-0365, Rate Order Working Papers, Schedule 8, Pg.2, April 24, 2014
[7] Total 2013 in-franchise revenue requirement of $202.5 million (M12 and C1) as per EB-2013-0365, Rate Order Working Papers, Schedule 8, Pg.2, April 24, 2014

updated information with respect to the timing of attachments and a larger than forecast request for firm service as opposed to interruptible.

Following approval of the leave to construct application, Union began the process of contracting for the type of service (firm or interruptible) and the quantity of gas specific to each customer. Customers had the option of selecting a minimum annual volume ("MAV") with a contractual commitment or paying a cost per acre as an aid. The costs attributed to customers requesting service was set at $10,300 per acre for interruptible service and $20,500 per acre for firm service. The calculation of the term was based on the allocated cost of the transmission line plus the site specific distribution costs plus the revenues derived from multiplying the MAV with approved rate for service over a ten year period to bring the PI to 1.0.

OGVG in its submission titled, "Summary Points in Argument from OGVG" dated June 9, 2014, alleges that it was inappropriate for Union to insist on an upfront aid to construct payment or sign a contract with MAV and a term when the original leave to construct was granted on the basis of no aid to construct being required. On this basis, OGVG seeks renegotiation of the contracts that were signed pursuant to the leave to construct.

In its Argument-in-Chief, Union submitted that it did not require an upfront aid to construct but did require some mechanism to ensure that the forecast of revenues which underpinned the DCF analysis submitted to the Board would be met. Union therefore required a contractual revenue commitment from its customers. In the absence of such a commitment, Union submitted that its other ratepayers would be at risk if the customers did not attach to the Leamington Line or did not consume gas as forecast. Union therefore considers its approach with respect to the Leamington Line as appropriate.

At the oral hearing Board staff sought Union's position on whether the Board had jurisdiction to amend the terms of the contracts that Union offered to customers on the Leamington Line Project. In its Argument-in-Chief, Union agreed that the Board through its ratemaking powers had the jurisdiction to vary the amount paid by the customers in question. However, Union did express doubts on the question whether the Board had the required jurisdiction to relieve these customers entirely of their contractual commitments.

Board staff agrees with Union that the Board has the power to vary the amounts paid by M4 and M5A customers (or any other customers) for service. It is also Board staff's view that, under appropriate circumstances, the Board would have the jurisdiction to alter contractual commitments that had been agreed to between a utility and a customer. Section 36(1) of the Act is in fact clear that the Board is not bound by the terms of any contract in setting rates.[8]

Board staff's position is consistent with the broad interpretation the Board applied to the term "rate" in the recent Natural Resource Gas/ Integrated Grain Growers Co-operative Inc. proceeding (EB-2012-0396), in which there was a dispute regarding an aid to construct payment. The Board in that Decision determined that capital contribution is a rate and lies within the exclusive jurisdiction of the Board under Section 36[9].

At the oral hearing, Union's witness confirmed that OGVG members were given the option of paying an aid to construct, or signing a contract guaranteeing a minimum volume for a minimum term[10]. It appears to Board staff that a contractual requirement to commit to a certain volume and term qualifies as a "rate" within the meaning of the Act.[11]

Board staff therefore submits that the Board has the required jurisdiction to alter the contractual commitments. However, the precise nature of the relief sought by OGVG in this proceeding remains unclear to Board staff.

– All of which is respectfully submitted –

[8] Section 36(1) states: "No gas transmitter, gas distributor or storage company shall sell gas or charge for the transmission, distribution or storage of gas except in accordance with an order of the Board, which is not bound by the terms of any contract."
[9] Decision with Reasons, EB-2012-0396, p.16, February 7, 2013
[10] EB-2013-0365 Transcript, Volume 1, pp. 158-159, June 5, 2014
[11] The Act defines a rate as: "a rate, charge or other consideration and includes a penalty for late payment."