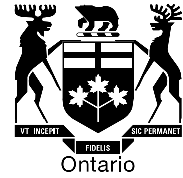
Ontario Energy Board

Commission de l'Énergie de l'Ontario



EB-2013-0365

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 approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas commencing January 1, 2014.

BEFORE: Paula Conboy
Presiding Member

Christine Long
Board Member

Ellen Fry
Board Member

DECISION AND ORDER

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 (the "Act"), for an order or orders approving rates for the distribution, transmission and storage of natural gas, effective January 1, 2014. The Board assigned file number EB-2013-0365 to the Application and issued a Notice of Application on November 22, 2013.

The application was based on a Board approved settlement agreement of a multi-year IRM framework for the period 2014-18 (EB-2013-0202).

The Board issued its Procedural Order No. 1 on December 20, 2013, which established the approved list of intervenors for this proceeding. The list is:

- Association of Power Producers of Ontario (“APPrO”)
- Building Owners and Managers Association Toronto (“BOMA”)
- Canadian Manufacturers and Exporters (“CME”)
- City of Kitchener (“Kitchener”)
- Consumers Council of Canada (“CCC”)
- Enbridge Gas Distribution Inc. (“Enbridge”)
- Energy Probe Research Foundation (“Energy Probe”)
- Federation of Rental-housing Providers of Ontario (“FRPO”)
- Industrial Gas Users Association (“IGUA”)
- Jason F. Stacey
- London Property Management Association (“LPMA”)
- NOVA Chemicals Canada Ltd. (“NCCL”)
- Ontario Association of Physical Plant Administrators (“OAPPA”)
- Ontario Greenhouse Vegetable Growers (“OGVG”)
- Ontario Power Authority (“OPA”)
- School Energy Coalition (“SEC”)
- Shell Energy North America (Canada) Inc. (“Shell Energy”)
- Six Nations Natural Gas Company Limited (“SNNG”)
- TransCanada Pipelines Limited (“TCPL”)
- TransCanada Energy Ltd. (“TCE”)
- Vulnerable Energy Consumers Coalition (“VECC”)

The Board also determined that APPrO, BOMA, CCC, CME, Energy Probe, FRPO, IGUA, Kitchener, LPMA, OAPPA, OGVG, SEC and VECC were each eligible to apply for an award of costs under the Board’s *Practice Direction on Cost Awards*.

The Board also declared the current rates of Union interim effective January 1, 2014.

Union reached settlement in this proceeding in two phases. The first phase covered settled issues affecting rates effective January 1, 2014. The second phase covered the Parkway Delivery Obligation.

Union’s large volume direct purchase customers east of Dawn have an obligation to deliver gas at Parkway (the “Parkway Delivery Obligation”). In the 2013 rates proceeding (EB-2011-0210), Union’s direct purchase customers requested that Union eliminate the Parkway Delivery Obligation and allow customers to deliver gas to Union at Dawn because the cost to these customers to maintain the obligation exceeded the delivery rate benefit of the obligation. In EB-2011-0210, the Board ordered Union to form a working group with the intervenors and report on the outcome in the 2014 rates

proceeding. Consequently, Union filed a proposal to eliminate the Parkway Delivery Obligation in this application. The settlement discussion revolved around reaching a mutually acceptable agreement to eliminate this obligation.

Union filed a Settlement Agreement for the first phase on April 24, 2014. The Board accepted the April 24, 2014 Settlement Agreement for the first phase by way of Decision and Procedural Order No. 3 dated May 12, 2014 and approved rates effective January 1, 2014 to be implemented June 1, 2014.

Union filed an update to the Settlement Agreement on June 3, 2014 to add a settlement on the Parkway Delivery Obligation issue (the “Updated Settlement Agreement”). By way of a Decision and Order dated June 16, 2014, the Board accepted the Updated Settlement Agreement.

In the Updated Settlement Agreement, Union reached a settlement with the parties on all issues with the exception of:

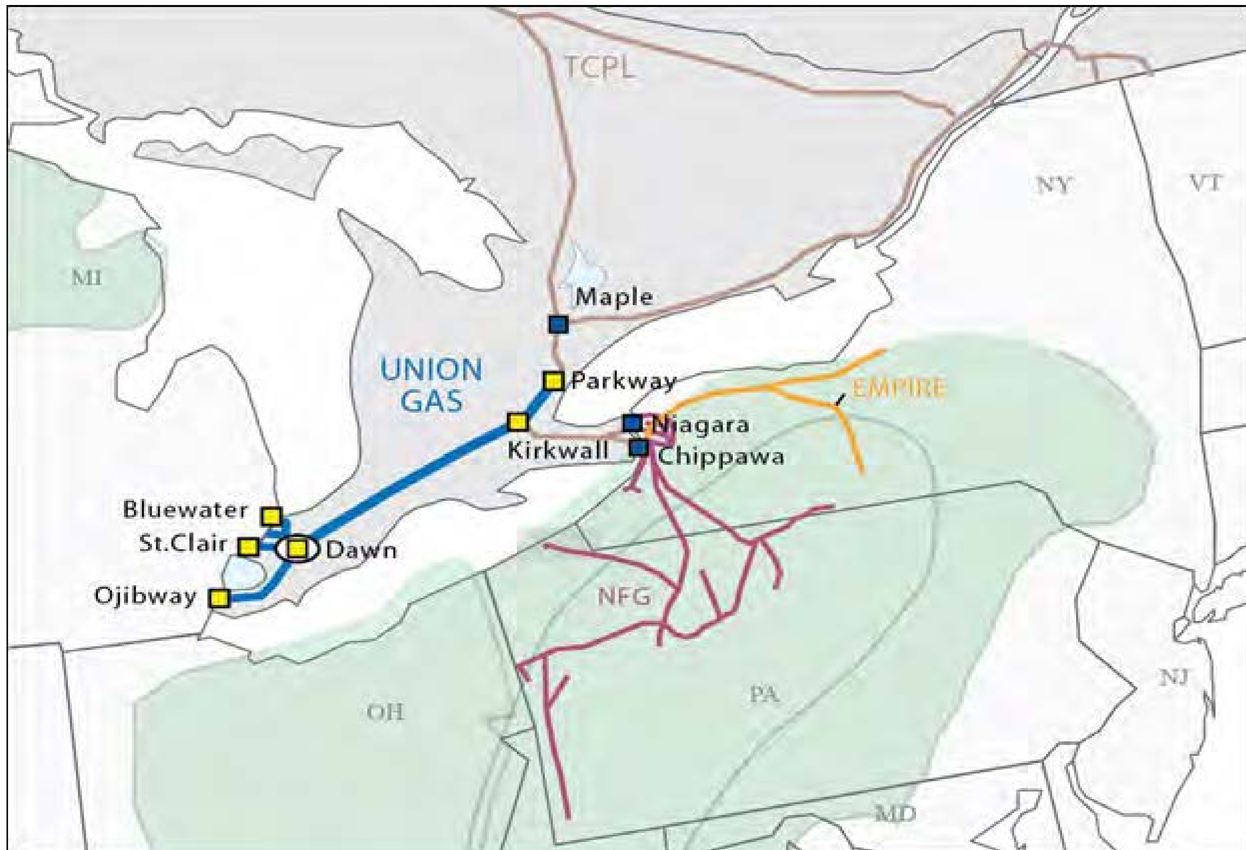
1. Allocation of Kirkwall Metering Costs; and
2. the Leamington Line Project.

The Board held an oral hearing on June 5, 2014 concerning these two issues. In Procedural Order No. 5 issued on June 6, 2014, the Board made provision for the parties to file argument on these two issues.

While the Leamington Line Project was not an issue that was brought forward by Union in its application, the parties agreed to add it as an issue to the current proceeding.

Allocation of Kirkwall Metering Costs

The Kirkwall Station is an interconnection between Union Gas and TransCanada Pipelines Limited, located on Union’s Dawn-Parkway transmission line (previously known as the Dawn-Trafalgar system). The Kirkwall interconnection has been historically used to export gas to the US at Niagara and Chippawa. The map below shows the location of Kirkwall within Union’s Dawn-Parkway transmission system. Natural gas in the Dawn-Parkway transmission system flows in both directions.



The Kirkwall interconnection was first addressed in 1997 when the Board in its EBRO 493/494 Decision acknowledged the bi-directional flow of the Dawn-Trafalgar system but noted that on design day[1], all gas was flowing easterly. Accordingly, the Board determined that Union's methodology to allocate costs based solely on easterly flows and a commodity-kilometer allocation factor was appropriate[2].

In September 2010, Union made an application (EB-2010-0296) for approval of a firm C1 Kirkwall to Dawn rate and a firm M12-X rate, both effective September 1, 2011. This was to allow Union to receive volumes at Kirkwall. Union also proposed to make modifications to its existing facilities at Kirkwall to allow for the reversal of flow (and bi-directional flow). Although some portions of the Dawn-Parkway system facilitated bi-directional flow, Kirkwall was not a bi-directional point on the Dawn-Parkway system prior to 2011.

[1] A 24-hour period of demand which is used as a basis for planning gas capacity requirements

[2] Decision With Reasons, EBRO 493/494, March 20, 1997, Section 9.4.31

In its EB-2010-0295 Decision, the Board determined that Union should review cost allocation and rate design for the proposed transportation services at Kirkwall at the time of rates rebasing[3].

In EB-2011-0257 Union applied for approval of a firm C1 Kirkwall to Parkway rate and a firm M12 Kirkwall to Parkway rate, both effective November 1, 2012. The Board approved the new rates but directed Union to review the rate-making methodology for the new transportation services through Kirkwall as part of its rebasing in 2013[4].

In that subsequent 2013 rebasing proceeding (EB-2011-0210), LPMA raised the specific issue of the allocation of Kirkwall Metering costs. LPMA submitted that the use of the Kirkwall Station, including flows of natural gas, had changed substantially over the years (with increasing reverse flow, Kirkwall to Parkway/Dawn) and that there was a clear need to review the allocation of Kirkwall Station costs. As a result, the Board directed Union to undertake a review of the allocation of Kirkwall metering costs as part of an updated cost allocation study to be provided in its 2014 rates proceeding (i.e. this proceeding)[5].

Union submitted that it had reviewed the allocation of Kirkwall metering costs and based on the review, it was not proposing any changes to the methodology.

Although Union acknowledged that the use of the Kirkwall Station had changed over time, Union submitted that its cost allocation methodology used to allocate Kirkwall metering costs was appropriate as it treats the facilities in a manner consistent with other Dawn-Parkway assets. Union allocates Kirkwall costs to in-franchise and ex-franchise rate classes depending on the design day demands and the distance those design day demands are required to be transported along the Dawn-Parkway transmission system.

Accordingly, Union submitted that its allocation methodology was appropriate but that it would review the methodology again at the next rebasing proceeding in 2019.

[3] Board Decision EB-2010-0296, Pg. 8, November 30, 2010
[4] Board Decision EB-2011-0257, Pg. 6, September 13, 2011
[5] Board Decision EB-2011-0210, Pg. 74, October 25, 2012

Intervenors were essentially split with respect to whether the cost allocation for the Kirkwall Station should be updated as part of this proceeding or be reviewed at the next rebasing. While FRPO, APPrO, CME, Kitchener, OGVG and BOMA supported a change to the cost allocation in rates effective January 2015, CCC, Energy Probe, LPMA and Board staff agreed with Union's proposal of reviewing the cost allocation in the next rebasing proceeding. SEC and IGUA took no position on the issue.

FRPO disagreed with Union that the Kirkwall Metering assets used to supply both in- franchise and ex-franchise customers. FRPO argued that Kirkwall is used mainly to provide ex-franchise services and does not contribute to the easterly design day requirements.

CME, FRPO, OGVG and Kitchener retained the services of Mr. John A Rosenkranz to prepare evidence on issues related to cost allocation. His analysis was filed as evidence[6] in this proceeding.

Mr. Rosenkranz disputed the distance-weighted methodology adopted by Union and noted that meter and regulator ("M&R") plant and M&R operating and maintenance costs are not affected by the distance gas is transported either upstream or downstream of the Kirkwall station.

Mr. Rosenkranz maintained that the distance based factor that Union currently applies to Kirkwall is incompatible with principles of cost causality for M&R plant. Rather, M&R costs are caused by the volumes that flow through the meters regardless of whether the gas is flowing in one or two directions. The distance of travel has no causal connection with the M&R costs being allocated. Mr. Rosenkranz therefore recommended that Kirkwall M&R costs should be directly assigned to customer classes and costs that cannot be directly assigned should be allocated on the basis of peak day demands.

APPrO agreed with Mr. Rosenkranz's recommendation of changing the methodology to allocate Kirkwall M&R, and O&M plant costs. APPrO further submitted that the changing gas flows at Kirkwall clearly determine that the predominant function of Kirkwall was to receive US shale gas and the use of the facilities to meet easterly demands was secondary.

[6] Intervenor Evidence, "Review of Dawn-Parkway System Cost Allocation Issues", February 10, 2014

CME referred to Mr. Rosenkranz's conclusion that Union's in-franchise customers were being over-allocated costs associated with the Parkway, Kirkwall and Dawn Stations. CME also referred to the other recommendation of Mr. Rosenkranz that Kirkwall and Parkway M&R costs that can be directly assigned to customer classes should be directly assigned and those costs that cannot be directly assigned should be allocated on the basis of peak day demands. CME submitted that both these changes should be implemented by the decision in the current proceeding.

OGVG supported the submissions of CME and FRPO on this issue.

BOMA submitted that the Kirkwall metering costs should be allocated on a design day basis and not on a distance-weighted design day basis[7]. BOMA maintained that unlike pipeline and compression costs, metering costs do not vary with distance. There was therefore in its view no basis for metering costs to be allocated on a distance-weighted design day basis.

Board staff submitted that the gas supply dynamics for Kirkwall have changed significantly in recent years and that as a result the cost allocation methodology that seemed appropriate before may no longer be considered suitable. Board staff noted that Union's response to interrogatory B1.3 indicated that approximately 35% of the volume flows in the reverse direction (from Kirkwall to Dawn/Parkway) through the Kirkwall Station. Board staff submitted that these reverse flow volumes are significant and there are definitely certain costs associated with moving them, but that Union does not allocate any costs to the reverse flow volumes. Accordingly, Board staff submitted that from a cost causality standpoint, the cost allocation methodology for Kirkwall should be changed to reflect the bi-directional flow.

LPMA, CCC and Board staff submitted that changes to cost allocation during an IRM term should only be made if there is a compelling reason to do so and the impact is significant. Under an IRM approach rates are to be adjusted mechanistically and IRM proceedings could become cumbersome if cost allocation models were frequently reviewed and adjusted.

[7] Distance-weighted design day basis refers to an allocation based on volumes that flow on a peak day and the distance those peak day volumes are transported.

LPMA and Board staff submitted that if the cost allocation methodology was changed to take into account the bi-directional flow, the annual cost shift in favour of in-franchise customers would be approximately $217,200 for 2013 as per Exhibit B1.3. Board staff and LPMA submitted that this amount is not material given that it represents about 0.03% of Union's total revenue for in-franchise customers[8].

LPMA, CCC, Energy Probe and Board staff submitted that a cost allocation review and any resulting adjustments would be appropriate at Union's next rebasing proceeding. Union agreed that any such adjustments should be made at its next rebasing proceeding rather than in this proceeding.

Board Findings

While the Board agrees that rates under IRM should generally be limited to mechanistic adjustments and that updates for other reasons should generally be avoided, Union was directed by the Board in a previous decision to undertake a review of the Kirkwall metering costs in this proceeding. In that decision (EB-2011-0210), the Board directed Union to undertake a review of the allocation of Kirkwall metering costs as part of an updated cost allocation study to be filed in its 2014 rates filing.

As indicated above, Union submitted that it did conduct a review of the Kirkwall metering costs and concluded that no change to the cost allocation methodology was warranted. However, Union did not provide any quantitative evidence to support its conclusion. Rather, Union stated that its conclusion was based on consistency with the allocation methodology for other Dawn-Parkway assets. However, one of Union's witnesses testified that in his view there could be several reasonable approaches to cost allocation.

The Board does not consider that Union responded adequately to the Board's direction in EB-2011-0210. Union did not provide any quantitative evidence to support its position that no change is required. At the time of its decision in EB-2011-0210 the Board knew that Union would be under some form of incentive ratemaking framework in 2014, but still directed Union to undertake a review of Kirkwall Station costs in its 2014 rates proceeding. The Board's clear expectation was that the issue would be dealt with in this

[8] 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

proceeding and that Union would provide sufficient evidence in this proceeding to respond to the Board's direction.

Under the current methodology used by Union, customers that use the reverse flow (from TCPL to Dawn/Parkway) are not paying any of the costs of Kirkwall metering station despite the significant flows[9]. The Board agrees with CME, Board staff, FRPO, APPrO and BOMA that the current methodology is inconsistent with cost causation.

Some of the intervenors are not opposed to the cost allocation adjustment but are of the view that the adjustment amount is insignificant and changes to cost allocation should not typically be done during an IRM period. Board staff in its submission notes that a readjustment would result in a cost shift of $217,200 for 2013 which represents a very small portion of Union's total revenue for in-franchise customers. However, when compared to the total Kirkwall metering costs, the cost adjustment represents approximately 14% of the total costs[10].

Customers that are currently benefitting from the bi-directional service should pay an appropriate share of the costs. It is not fair to other ratepayers if customers that are using the reverse flow (Kirkwall to Parkway/Dawn) service are not allocated any costs for the Kirkwall Station.

Accordingly, the Board requires Union to adjust its cost allocation methodology to take into account all volumes flowing through the Kirkwall metering station and allocate costs based only on demand. Union is ordered to make the appropriate adjustment for rates effective January 1, 2015 and file it as part of its 2015 IRM rates application.

Leamington Line Project

In November 2012 in EB-2012-0431 (the "leave to construct proceeding"), Union applied for leave to construct a pipeline in the Leamington area ("the Leamington Line Project") to meet growing demand from greenhouse growers. Union initially submitted that, consistent with the Board's policy established in E.B.O. 188, it needed an aid-to-construct capital contribution as the revenue and cost forecast for the initial ten year

[9] Exhibit B1.3 – flows from Kirkwall to Dawn/Parkway are approximately one-third of the total flows
[10] Board staff submission, June 20, 2014, Pg. 4

period resulted in a profitability index ("PI") lower than 1.0. Union submitted that it required an aid-to-construct of $2.092 million to reach a PI of 1.0.
However, later in that proceeding Union updated its discounted cash flow[11] analysis to reflect changes in forecast project costs, the timing of attachments and a change in the proportion of requests for firm (as opposed to interruptible) service. As a result of the updated analysis, Union informed the Board that it no longer required a capital contribution from the greenhouse growers. The Board approved the application on that basis.

Following approval of the leave to construct application, Union concluded contracts with individual customers that would obtain service from the Leamington Line Project. Customers had the option of committing to a minimum annual volume for a fixed term or paying an upfront amount per acre of their operations. Customers were required to commit to payments under these arrangements that covered the project costs allocated to them. The costs allocated to customers were set at $10,300 per acre for interruptible service and $20,500 per acre for firm service. The overall project cost allocated among customers was based on the cost of construction plus the site specific distribution costs minus the forecast revenues over a ten year period, to bring the PI to 1.0.
Union's position is that it required some mechanism to ensure that the forecast of revenues which underpinned the discounted cash flow analysis submitted to the Board would be met. Accordingly, Union submitted that it required a revenue commitment from the new customers. Union submitted that in the absence of such a commitment, other ratepayers would be at risk.

OGVG argued that the Board should relieve the greenhouse growers of their contractual commitments to Union and permit them to renegotiate their contracts.
Some of the intervenors supported the position of Union. LPMA submitted that the customers that created the need should pay for the costs associated with the project. LPMA submitted that the OGVG approach undermined the E.B.O 188 guideline that ensures that customers creating the demand for additional investments pay the cost, rather than having existing customers subsidize new customers. LPMA noted that the only reason no upfront aid to construct was required was because the forecast revenues generated from the contractual commitments were sufficient to cover the cost

[11] A valuation method used to estimate the attractiveness of an investment opportunity. Discounted cash flow analysis uses future free cash flow projections and discounts them (most often using the weighted average cost of capital) to arrive at a present value, which is used to evaluate the potential for investment.

of the project. In the absence of such commitments, an aid-to-construct would be required to allow the project to go ahead.

Energy Probe submitted that the issue was brought before the Board mainly as a result of inadequate communication between Union and OGVG members as to what should be expected at the project implementation and contracting stage. CCC made similar submissions.

IGUA expressed concern regarding Union's specific contracting practices and argued that the Board should require Union to seek approval of its practices in requiring contractual commitments from delivery customers in support of system expansions.

CME submitted that based on the Board's Decision in EB-2012-0396, the minimum annual payment provisions of the contracts constitute a "rate" and therefore require Board approval. CME further noted that the Board's Decision in EB-2012-0431 did not approve the minimum annual payment provisions of the contracts that were subsequently entered into by Union with the greenhouse growers. CME therefore submitted that the annual payment provisions were not enforceable.

BOMA submitted that the greenhouse growers should be free to choose a one-year renewable contract without an upfront payment to Union.

OGVG submitted that Union was discriminating between new and existing customers by requiring new customers to commit to long term contracts with minimum annual volume requirements while existing customers were free to contract at volumes that represented their actual volumetric needs. Existing customers were also permitted to terminate their contracts at the conclusion of any contract year. OGVG submitted that Union should be compelled to obtain more precise information from its customers with respect to their consumption needs, in terms of both supporting the load forecast that underpins the cash flow analysis and the proposed capacity for projects going forward.

OGVG further submitted that the recovery of capital costs from each customer inappropriately shifts the risk of the project to the new customer from Union's shareholder. OGVG therefore submitted that customers should have the option to renegotiate the terms of their contracts, allowing them to take into account their actual forecast consumption requirements. OGVG also wanted their members to have the

ability to terminate the contract with a three month notice prior to the end of a contract year.

OGVG submitted that going forward, the process concerning customer commitments should be clearly set out in a Board approved process.

OGVG submitted that the Board should set aside the minimum annual volume requirements of the contracts as unenforceable given that in its view they constitute a rate not approved by the Board.

SEC adopted the submissions of CME and accepted the arguments of OGVG. However, it took no position on the relief sought by OGVG.

SEC noted that Union enjoyed considerable freedom to stipulate contract terms. SEC submitted that Union should not be free to contract as it did for the Leamington Line Project without prior approval of the Board.

Union disagreed with OGVG's claim that it did not take into account the actual use of the specific greenhouse growers. Rather, it was the specific greenhouse growers, having regard to their own business operations that advised Union of their respective volume requirements. Union argued that there was no evidentiary basis to conclude that any of its consumption assumptions were unreasonable. The minimum annual volumes reflect a commitment to consume a given quantity of gas for a period of time at the Board-approved M4 or M5A rate.

Union further submitted that there was nothing new about its approach of requiring a multi-year commitment. It was entirely appropriate in its view to ensure that the well-defined group of customers that created the need for the specific capital project, and which benefit from that expansion, pay for it. Union rejected the claim that it was discriminating between new and existing customers and argued that it required a contractual commitment from new customers absent which the costs would have to be borne by Union and other customers.

In response to the submissions that Union should seek pre-approval of the contract terms, Union noted that it had never sought pre-approval of the terms of distribution contracts to be entered into following a leave to construct application and submitted that

E.B.O 188 does not contemplate such approval. Union also submitted that the M4 and M5A rate schedules contemplate the possibility of parties entering into multi-year contracts.

Concerning future expansion projects, Union maintained that the Board should not make any decisions until it has a full evidentiary record on each particular application. Union noted that OGVG was free to forward its position in future applications.

Board Findings

The Board in a previous proceeding has determined that a capital contribution is a “rate” as contemplated by section 3 of the Act . None of the parties have disputed this. Accordingly the Board has jurisdiction to determine the amounts of capital contribution for the Leamington Line Project[12].

Union’s application for leave to construct the Leamington Line was filed in response to a request for additional natural gas service from greenhouse growers in the Leamington area. Union conducted an “open season” (a process to obtain expressions of interest from prospective customers) and the response guided Union’s forecast of loads and costs. Union prepared a discounted cash flow analysis based on ten years of gas use from the customer group. As indicated above, Union’s forecast presented in the leave to construct proceeding resulted in a PI of more than 1.0, and as a result an upfront capital contribution was not required.

The Board notes that OGVG could have intervened in the leave to construct proceeding but did not do so. That proceeding would have been the correct forum for OGVG to challenge the assumptions and methodology used by Union in allocating project costs among greenhouse growers, if OGVG wished to do so. The Board’s decision in the leave to construct proceeding was based on the premise that volume commitments by the greenhouse growers as contemplated in Union’s forecast would result in a project that was financially viable.

[12] In EB-2012-0396 (February 7, 2013), the Board determined that capital contribution is a rate and the Board had jurisdiction to determine the capital contribution amounts payable by Integrated Grain Processors Co-operative to Natural Resource Gas Limited.

Although the Board's decision did not require this contribution to be in the form of an upfront aid-to-construct payment from the greenhouse growers, it clearly contemplated that Union would need to recover the $2.0 million shortfall in revenues.

Accordingly, it was appropriate for Union to require a contractual commitment or upfront payment from each greenhouse grower to ensure that the costs of the pipeline were borne by the customers that cause them to be incurred. In the absence of such a commitment, Union would be faced with the risk of collecting less revenue than was required to fund the project. The deficiency in revenues would then have to be recovered from other ratepayers.

The Board has therefore determined that it will not require Union to renegotiate the contracts with the greenhouse growers or alter the minimum annual volume commitments.

Several parties have submitted that the Board should approve general parameters concerning Union's practices in this type of situation. The Board finds that such issues should be explored within the relevant leave to construct proceedings.

THE BOARD ORDERS THAT:

1. The intervenors shall file with the Board and forward to Union, their respective cost claims for this proceeding within 14 days from the date of this Decision and Order.

2. Union shall file with the Board and forward to the intervenors any objections to the claimed costs within 21 days from the date of this Decision and Order.

3. The intervenors shall file with the Board and forward to Union any responses to any objections for cost claims within 28 days of the date of this Decision and Order.

4. Union shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

All filings to the Board must quote the file number, EB-2013-0365, be made electronically in searchable / unrestricted PDF format through the Board's web portal at https://www.errr.ontarioenergyboard.ca. Two paper copies must also be filed. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at http://www.ontarioenergyboard.ca/OEB/Industry. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

ADDRESS

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4
Attention: Board Secretary

E-mail: boardsec@ontarioenergyboard.ca
Tel: 1-888-632-6273 (Toll free)
Fax: 416-440-7656

DATED at Toronto, August 21, 2014
ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary