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December 19, 2014

EMAIL, RESS & COURIER

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

Dear Ms Walli:

Re: EB-2014-0012 – Union Gas Limited – Hagar Liquefaction Service Rate

Please find attached the Reply Submissions of Union Gas Limited.

Yours truly,

Charles Keizer

CK/

cc: EB-2014-0012 intervenors
Karen Hockin (Union Gas)
Michael Millar (Legal Counsel, OEB)

11229-2103 18605425.1

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,* for an order or orders approving rates and other charges for an interruptible natural gas liquefaction service.

REPLY SUBMISSIONS OF UNION GAS LIMITED

These are the reply submissions of Union Gas Limited ("Union") in respect of this matter.

The various submissions of the intervenors and Board Staff fall into the following categories, which will be addressed in turn in these submissions:

- the application of Union's Undertaking to the Lieutenant Governor in Council, which, Union submits, has been misinterpreted and misapplied by various intervenors;
- cost allocation – with respect to (i) the appropriate allocation of storage costs that reflects the use of storage in accordance with the nature of the service offered; and (ii) the inclusion of all incremental costs;
- risk responsibility, which is effectively assumed by Union while providing protection to the rate payer;
- revenue sharing that is consistent with Union's IRM arrangement and NGEIR decision;
- the proposed cross charge should be based on a dollars per GJ basis.

Each of these categories will be addressed below.

A. The Undertaking

Section 2.1 of Union's undertaking provides that:

> "Union shall not, except through an affiliate or affiliates, carry on any business activity other than the transmission, distribution or storage of gas, without the prior approval of the Board."

Contrary to the assertions of CME, BOMA and Energy Probe, Union is compliant with the above undertaking. CME and BOMA assert that the liquefaction service departs from Union's utility gas transmission, distribution and storage business. However, in taking this position, intervenors fail to consider the manner in which Union's liquefaction service offering will be executed.

Union's liquefaction service offering is effectively the distribution of gas from the point of delivery for the Northern Delivery Area ("NDA") to the nozzle that dispenses the customer's LNG. Simply put, LNG regardless of its liquid state is a gas for purposes of the *Ontario Energy Board Act* (the "*OEB Act*"). From the delivery point of the NDA to Hagar the gas is transported on Union's system. At Hagar, the liquefaction process is applied to take the gas from the gaseous to a liquid state. This is no different than placing gas under higher pressure for delivery to particular customer - albeit pressure taken to a more extreme level. The gas is either transported through the Hagar facility and the dispensing facility to the waiting tanker truck (based on previous established delivery schedule) or because of temporary differences between gas delivery and receipt requiring balancing, stored in the LNG tank for later delivery in the applicable month (Argument-in-Chief, p. 6). Under the *OEB Act* a "gas distributor" means a person who delivers gas to a consumer. All of the above incorporates aspects of distribution and storage undertaken by Union in respect of natural gas. As such, Union is compliant with its undertaking.

Union's compliance does not change if the Board chooses to forbear under section 29 of the *OEB Act* with respect to regulating Union's liquefaction service. Union will continue to carry out the activities of distribution and storage that it is entitled to do even though the Board may have chosen not to regulate it.

The Board's approval in respect to Union's undertaking is not required as part of Union's liquefaction service and any conditions proposed by CME or BOMA should not apply. In particular, BOMA asserts that the proposed service should be carried out through a corporate affiliate and not as a non-utility activity. Given the nature of the service as described above and Union's compliance with the undertaking, there is no requirement to carry out the service through an affiliate. It is important to note that contrary to the assertions of the intervenors, Union's non-utility storage business is not carried out by an affiliate, but is undertaken by Union itself. There is no reason to distinguish between that business and the proposed liquefaction service with respect to its non-utility arrangements.

B. Cost Allocation

With respect to the cost allocation analysis provided by Union as part of establishing either the Rate L1 applicable to the regulated service or the cross charge in respect to the unregulated service, the intervenors raise two general issues that relate to:

(i) the appropriate allocation of storage costs; and

(ii) the scope of incremental costs.

Allocation of Storage Costs

CME takes the position that Union's cost allocation approach does not result in the appropriate share of fully allocated costs because Hagar is an integrated facility whose functions cannot be reasonably disaggregated (CME, p. 4) and that the functionalized approach understates the usage of the Hagar facility by the liquefaction service. CME's submissions are directed only to the allocation of costs in respect of the storage function (CME, p. 5). This position is also echoed by Energy Probe (Energy Probe, p. 10).

However, CME and Energy Probe's positions are unfounded and reflect a fundamental misunderstanding of how LNG storage for system integrity operates and also of the nature of Union's liquefaction service offering.

CME believes that Union's allocation of 1% of the annual functionalized storage cost to the liquefaction service is too low. However, this allocation is appropriate because it relates to the 7000 GJs of storage that forms part of Union's service design.

At the core of Union's liquefaction service offering is the preservation of system integrity capacity of the Hagar facility. Many parties have diminished the relevance of system integrity by asserting its limited importance based on past use of Hagar's capacity. However, system integrity is a significant utility aspect that is directly linked to the wellbeing of rate payers. System integrity is intended to protect the system and customers from unforeseen and unplanned events that go directly to the operation and service of the system. For example, if there were upstream supply failures or operating restrictions on another pipeline, Union would use its system integrity resources (Hagar in the case of Union's NDA) to meet demand. The need when called upon could be small or it could be significant, but its purpose is to be available for the eventuality that can happen but hopefully does not. However, if it is required Hagar can be emptied in six or seven days. However, it can take up to 200 days to refill. It must be ready for the commencement of the winter heating season.

Intervenors pointed to the infrequency of use of the Hagar Facility and storage availability. However, the fact that the frequency or volume used is low does not point to an excess of storage at Hagar. Instead, it points to the fact that the system has avoided a material unplanned event and that integrity of the system remains preserved and protected by the volumes held at Hagar.

If, as suggested by some parties, Union ignores the system integrity function of Hagar and uses the system integrity capacity for the sale of LNG, then the ability to respond to unplanned and potentially significant events would be forgone and rate payers will be exposed. In effect, intervenors are suggesting that the Board ignore Union's operating parameters and to make system integrity decisions implicitly through its consideration of the allocation of cost allowing Union's customers to take the risk of this redesigned system integrity function.

As a result, respecting the importance of system integrity, Union has designed its service to ring fence its system integrity capability relative to its liquefaction service. As Ms. Van Der Paelt stated:

> ". . . it is physically mixed, but on a contractual basis we are going to manage to the 7,000 to make sure that we don't infringe on the integrity space," (Transcript Vol. 3, p. 26)
>
> "So we wanted to ensure in the service design that we didn't make any assumptions around a system integrity event and that we preserve the reliability of that asset and preserve that for Union Gas and for those system integrity events.
>
> So if our service design assumed that you could take advantage of that space or do something differently with that, you then made a leap of faith that there hasn't been an integrity event in that winter." (Transcript Vol. 3, p. 27)
>
> ". . . For us to make an assumption that that integrity event didn't happen and, therefore, there was additional space available to us would then lead us to believe

> that you didn't need the entire asset for the integrity space, which we believe we do." (Transcript Vol. 3, p. 27-28)

Through its capital investment in laser technology measurement to establish 7000 GJs of storage, Union is able to establish storage that is allocated to the LNG service use and keep Hagar's system integrity intact. Therefore, contrary to the assertion of CME, Hagar's storage is not an indivisible storage component that is to be taken as a whole for cost allocation purposes. The service is designed to only allocate costs for the storage used by the service, being the 7000 GJs. It employs only the 7000 GJs, by creating a "just in time" service where gas delivery and LNG services are scheduled and matched and any differences in such receipts and deliveries are balanced through the 7000 GJs with balances cleared within the contract month. This was described in Union's Argument-in-Chief. (Argument-in-Chief, p.6)

As a result, Union has appropriately allocated the storage costs on the basis of the storage capacity allocated to the liquefaction service. As stated by Mr. Erling:

> "I think the costs of storage are really related to the physical space that's allocated to the storage function. You know, it's a holding tank, and so the costs are really not dependent on the volumes that move in and out of the tank. They're really dependent on the volumes that you have to put in the tank, because that determines how large the tank is." (Transcript Vol.3, p. 17)

Mr. Erling also stated:

> ". . .To me it still seems that it's the capacity of the tank and the use of that capacity and how much capacity you are -- or how much space you are calling upon that's the important driver of cost." (Transcript Vol. 3, p. 22)

CME has also asserted that usage for storage capacity by Union with respect to its liquefaction service is much greater than 1% of the total usage because Union will cycle through the 7000 GJs of capacity an average of 59 times per year. However, this conclusion is incorrect. As stated by Union, Hagar is not traditional storage with distinct injections and withdrawals or cycles. Cycling has no bearing on how costs are functionalized or how rates are designated. (Transcript Vol. 3, p. 33, 34) Similar to other customers who pay for the space they have contracted for, such as under Rate T1 and T2, Rate L1 customers should also pay for the 7000 GJ's of storage at Hagar they will utilize.

No matter how much intervenors would wish the service to be designed differently, or how much Energy Probe imagines the service to be like the traditional park and loan service (which it is not) or how much Parties believe that system integrity should be ignored, these circumstances are not the basis on which Union designed its liquefaction service. The cost allocation employed by Union reflects the liquefaction service that Union has proposed. To the extent that a different cost allocation is created or established and that cost allocation is inconsistent with the service designed by Union, Union will not proceed with the service since it will not encroach on system integrity or pretend to do so through a cost allocation mechanism.

Incremental Costs

Various intervenors incorrectly asserted that the costs allocated by Union to develop the L1 Rate do not include certain incremental costs and the rate is, as a result, too low.

In general, Energy Probe disagreed with the use of a constant variable unit cost for incremental O&M costs. However, Energy Probe is incorrect in this regard. With the exception of salaries and wages, all forecast incremental costs (maintenance and operating expense, including compressor fuel) vary directly with the level of forecast sales activity. Therefore, it is appropriate to forecast those costs based on the level of activity. This is consistent with generally accepted forecasting and Board approved cost allocation methodologies. Union forecasts variable costs (e.g., UFG and compressor fuel) based on the level of activity and allocates those variable costs based on that activity. Union's approach to forecasting incremental variable costs for the liquefaction service is entirely consistent with established practices.

Energy Probe also raised questions related to compressor fuel. In particular, that there was no indication that the cost of compressor fuel will change with QRAM. (Energy Probe, p. 5-6, 10) However, that assertion is incorrect.

In this regard the record is clear. For compressor fuel specifically, Union takes the risk on the volume forecast but not on the price. To the extent Union's compressor fuel forecast of 90,000gj in 2018 is incorrect, this is Union's cost to manage.

> "MR. TETREAULT: Dr. Higgin, to close on compressor fuel, you had asked, in essence, have we accounted for the molecule -- if I understood your question

> properly -- in the 445,000 that's referenced in Exhibit A, tab 1, table 4. That's line 7.
>
> And the answer to that is, as Mr. Jones said, yes.
>
> So the 445,000 assumes 90,000 GJs of incremental compressor fuel at a WACOG at the time of about right around $5 per GJ. So that accounts for the entire $445,000.
>
> And as we mentioned earlier, of course all these forecast incremental costs are recovered in the proposed liquefaction rate." (transcript, Vol.2, page 79)

However, Union does not take the price risk. Contrary to Energy Probe's argument, Union clearly stated that the cost of gas associated with compressor fuel within the L1 rate will be updated with QRAM:

> "DR. HIGGIN: Just one other question, which is a follow-up: If the compressor fuel costs which are market-based vary with the market, how will they be dealt with in terms of updating that component of the rate as we go forward?
>
> MR. TETREAULT: We would, on a quarterly basis, if the rate were approved, we would update the component of the cost in the rate that relates to the cost of gas, very much like we do on a quarterly basis with QRAM for delivery-related cost of gas items.
>
> So as WACOG changes, the rate would change likely for the costs that are based on a WACOG.
>
> DR. HIGGIN: That would apply both to the gas you buy for system integrity, as well as for the transportation fuel, correct? You'd update it based on the quarterly QRAM?
>
> MR. TETREAULT: Yes. I may say it a little differently. I would say system integrity costs are in delivery rates, and within delivery rates as well are cost of gas related items, and those are updated as part of QRAM as WACOG changes every quarter.
>
> And that would be the case with this rate as well. The WACOG component will need to be updated regularly, as WACOG changes." (Transcript Vol. 2, page 82)

Energy Probe together with SEC assert that there are other incremental costs not accounted for such as liability insurance, equipment wear and tear and customer accounting and billing costs.

Contrary to Energy Probe's position, 2013 Board approved Hagar costs include an allocation of overhead or indirect costs. Specifically, Board approved costs include an allocation of general plant, general operating and engineering, and administrative and general expenses (e.g. salaries, benefits and insurance). (Exhibit A Tab 2 Schedule 2 lines 19-23; BOMA 14) To the extent indirect costs have been allocated to the system integrity function in Union's Board approved cost allocation study, the proposed Rate L1 liquefaction rate is providing a contribution to the recovery of those costs. This approach is consistent with the rate design that has been previously approved by the Board. Billing costs were added in the allocation of distribution customer costs based on incremental forecast number of customers.(Exhibit A Tab 2 p. 17 line 12)

Energy Probe also maintained that there should also be an inventory charge for timing differences in respect of storage. However, this is not correct because there are no inventory costs incurred by Union.

Whether the customer is delivering gas to the Union NDA directly, or buying gas from Union at the Union NDA, it is the customers' gas that is transported to Hagar and stored in the tank (up to 7,000 GJ). Union does not own the molecule in either case. Therefore, it would not be appropriate for Union to forecast carrying costs it is not incurring. As stated in the proceeding in response to Energy Probe:

> "MR. TETREAULT:...In this particular case, it will be the customer's gas or the customer's LNG that is in the tank, so Union is not incurring any carrying costs on those molecules. The customers themselves would be incurring that cost as part of maintaining, potentially, a level of inventory in the tank.
>
> DR. HIGGIN: You have an option where the customer buys gas from you?
>
> MR. TETREAULT: Correct. And when they buy the gas from us, it will be that they will own the gas. ....
>
> MR. TETREAULT: Yes, that's correct, because Union is not incurring any carrying costs on inventory for this particular amount of inventory. Customers are incurring that cost directly, by virtue of the fact it's their gas in storage. It's very much like T1 or T2 customers that we have who contract specifically for storage. They have an option not to pay Union's inventory cost when they are providing their own gas, and this is very much like that. The customer themselves are incurring the inventory cost in this circumstance, so there is no appropriate basis for us to also forecast carrying costs for gas and storage inventory for this purpose." (Transcript Vol. 2, p. 75)

BOMA challenged the level of incremental capital cost on the basis that the upgrades to the Township road should be disallowed. BOMA improperly characterised the payment for road upgrades as an expenditure "to ensure township and homeowners' approval for the new facilities". The evidence clearly shows the expenditures to be for the purpose of improving the condition of the road to ensure that LNG tankers trucks to have access to the LNG facility. (Transcript Vol. 3, p. 31). By paying for the road improvements, Union obtains the right to pursue the liquefaction service as part of dispensing LNG. The costs spent are similar to a capital contribution. Although Union will not own the road, its ability to use and access the road for purposes of the proposed service is contingent on the upgrades required and the capital payment is not unlike capitalizing other payments attributable to a project, such as salaries or third party costs.

As a result of the foregoing, Union submits that the L1 rate appropriately captures the incremental costs and should be accepted by the Board.

Union notes the general submission of Energy Probe that the functionalization study is not adequate or robust enough to provide for just and reasonable rates or accounting separation in the event of forbearance. The only basis that Energy Probe seems to provide for this position is that not all the costs have been included on a fully allocated basis and assumption related to the operation of storage. (Energy Probe, p. 11 and 17) However, Energy Probe's submission should not be accepted by the Board. As shown above, storage costs are correctly allocated relative to use and costs have been fully accounted for. As a result, Energy Probe's request for a deferral account should be denied.

C. Earnings Sharing

Prior to rebasing in 2019, it is Union's intention to retain the revenue arising from the regulated liquefaction service in the event the Board chooses not to forbear or a cross-charge if the Board chooses to forbear. This position with respect to revenue is entirely consistent with the Settlement Agreement approved by the Board in EB- 2013-0202.

In particular, the Board approved Settlement Agreement states:

> "To provide incentives for Union to seek productivity gains, either through achieving cost efficiencies or increasing revenue, while at the same time providing an opportunity for ratepayers to benefit from those initiatives during the IRM term, the 2014-2018 IRM would have an earnings sharing mechanism ("ESM") similar to Union's last IRM."

As part of IRM, Union made an upfront productivity commitment of $4.5 million or $22.5 million over the IRM term. The expectation is that Union would be able to meet that commitment through cost efficiencies or increasing revenues such as with the proposed service.

With respect to a test for inclusion into the ESM calculation, the Settlement Agreement also stated:

> "All revenues that would be included in revenues in a cost-of-service application would be included in the earnings calculation, and only those expenses (whether operating or capital) that would be allowable as deductions from earnings in a cost-of-service application would be included in the earnings calculation."

The revenue earned by Union as part of the regulated liquefaction service clearly is revenue that would be included in revenues in a cost-of-service application and as such should be included in the earning calculation as Union intended. Likewise, the reductions in expenses arising from compensation for the non-incremental costs allocated to the liquefaction service would also form part of the earnings calculation.

In effect, Union, in optimizing the use of Hagar's excess liquefaction capacity, is doing what is expected of a utility during an IRM period. It is expected that the utility will be incentivized to seek additional revenue and to drive productivity by cost reductions, which the utility will, subject to an ESM, retain the benefit of during the IRM period and be to the benefit of the rate payer at rebasing.

As stated by the Board in EB-2010-0296 relating to new transportation services:

> "Moreover, the Board agrees with Union that during the term of the IR, productively gains incremental to these included in the pricing formula accrue to the rate payer only in so far as they contribute to earnings sharing." (EB-2010-0296, p. 8)

Board Staff and the intervenors have ignored the plain language of the Board approved Settlement Agreement and ESM. They have attempted to do so by asserting that the agreement does not contemplate forbearance under Section 29 of the *OEB Act* and that such a circumstance is beyond the ambit of the agreement. However, the language of the Board approved Settlement Agreement is clear. It is the nature of the revenue and expense that matters and how it would be treated in a cost of service application. It is not the source of the revenue (utility or non-utility) that matters.

As a result, the Board should reject CME's, BOMA's and Energy Probe's position that the liquefaction as a non-utility service is outside the ambit of the Board approved Settlement Agreement and their respective submissions on revenue sharing. In particular, CME incorrectly maintains that Union has acknowledged that the non-utility service falls outside the ambit of the Settlement Agreement. Mr. Tetreault clearly clarified his statement on the record as follows:

> "MR. TETREAULT: Yes, the concept of developing a new service to generate utility revenue during IRM is contemplated in the incentive ratemaking mechanism.
>
> MS. BLANCHARD: Right. If Northeast's motion is successful and there's a determination that this is not a regulated service, is it your view that it's still consistent with the IRM?
>
> MR. TETREAULT: If there was a determination that the service is non-utility, I think it falls outside the ambit of IRM itself. I believe so, anyways. The reason I'm pausing is simply because of the non-utility cross-charge concept. I think that may be where there's a tie-back to IRM.
>
> And what I mean by that is if it's deemed to be a non-utility service, the non-utility business will need to pay for the use of utility assets at Hagar. And the way we've traditionally done that has been through a non-utility cross-charge. Effectively, the non-utility pays the utility for the use of the assets.
>
> So I paused on the IRM -- your IRM proposition, **because the cross-charge itself from the non-utility to the utility would be considered utility revenue, and it would be part of utility earnings during IRM and therefore subject to the earnings sharing mechanism we have in place over IRM as well.**
>
> **So the service itself could be non-utility, but aspects of the revenues or costs should or could still be considered part of utility earnings." (Transcript Vol 1, p. 86, 87) (emphasis added)**

Notwithstanding the clear terms of the Board approved Settlement Agreement, in the event the Board forbears, Board Staff argued that rate payers should receive a guaranteed benefit for the use of utility assets. This position is based on the assertion that the costs related to the utility assets are fully recovered from Union's North customers, the new service makes use of the regulated asset and similar facilities would cost more if built new.

These assertions wholly ignore the terms by which the IRM period is to be governed and are void of any applicable regulatory principle related to incentive rates or rate making generally. In essence, the Board Staff are saying that because Union North rate payers pay costs related to system integrity as a regulated service there should be revenue sharing.

However, this ignores the fact that Union, as noted above, has ring-fenced system integrity such that the customers that pay for system integrity continue to have it available unchanged and unaffected. This, as noted below, is the reason for the requirement that the liquefaction service be interruptible. Union's rate payers, consistent with an incentive rate regime, will receive a reduction in non-incremental cost by virtue of the allocation of costs to the liquefaction service. And, finally, the customers will gain the benefit of optimization of the Hagar Facility without a diminishment in system integrity or any exposure to the incremental costs that are fully the responsibility of Union. In addition, Union bears full responsibility for marketing and assuming the commercial risks of its liquefaction service.

Notwithstanding the foregoing, Board Staff also takes the position that in the case of forbearance, Union North Customers should recover 25% of revenue earned. This would occur even though as Board Staff fully acknowledges Union is taking the risk of the incremental capital and OM&A and volume short-falls. Board Staff provides no justification as to why Union North customers should receive a share of non-regulated revenue even though they bear no risk and incur no cost (both incremental and non-incremental) in respect of providing the proposed service.

SEC in essence takes the same position as Board Staff and Union submits that the Board should also reject SEC's position for the reasons stated above.

In the case where the Board chooses not to forbear, while Board Staff supports Union's rate design proposal, Board Staff does not follow the ESM and proposes an alternative sharing arrangement.

This is premised on the fact that if Union does not exceed a specific return on equity, the ESM is not triggered during IRM. As a result, there is no certainty that rate payers would receive any benefit through earning sharing during the IRM period. However, that is the nature of the ESM established in the Settlement Agreement and an incentive rate regime generally. An incentive is inherent in the regime for the utility to endeavour to raise revenue or reduce costs and as a consequence of such incentive the rate payer has the potential to share in the benefit. Board Staff cannot look for an alternative approach because on a singular matter that comes before the Board the receipt of a benefit is not guaranteed. The ESM and, in fact, the overall structure of incentive rates is not based on the guaranteed receipt of a benefit by rate payers. Any rate payer benefit is the cumulative effect of a variety of utility initiatives over the IRM period.

Notwithstanding that the Board Staff took the position that the Board should forbear from regulation, Board Staff expressed concerns that the LNG market is nascent and there is uncertainty regarding the eventual success of the market. On this basis, Board Staff asserted that the rate payer will underwrite the risk of the service and should share in the net revenues of the service. According to Board Staff, the risk is underwritten since "if the LNG service is approved as a regulated service, Union would have a reasonable expectation that the incremental capital expenditure would be added to rate base." It is hard to conceptualize as to how a reasonable expectation (which has not been shown to exist in evidence) amounts to an underwriting of risk by rate payers.

As with all discretionary capital expenditures that a utility seeks to add to rate base, Union is required at the time of rebasing to show that the incremental capital expenditure is prudent and in the interest of rate payers. Notwithstanding that Union will not order equipment until sales are at 50% capacity, Union remains exposed to the risk of disallowance if it cannot show the service as a whole is economically viable taking into account all factors including that the market is nascent. It would be reasonable to expect this latter aspect would factor into the Board's review and the nature of evidence required to establish prudence in the interests of rate payers. This similarly applies to incremental OM&A which the Board can adjust on rebasing.

Furthermore, Dr. Gaske in his testimony agreed that the Board has available to it any number of tools to ensure that risks and consequences remain with Union to the extent the service is not economically viable at the time of rebasing or subsequently. (Transcript Vol. 1, p. 32, 33)

The Board has the tools, discretion and powers available to it to insure that risks are allocated appropriately and that the rate payer is ultimately protected. In effect, the assertion that the rate payer underwrites the risk of the service is akin, at this juncture of the process, to an assertion that the Board is not capable of fulfilling its statutory and rate making object in respect of the public interest. Union believes that this is not the case and that it will bear the ongoing burden of proof and associated risk related to the service.

Board Staff also attempted to draw a parallel between the liquefaction service and Union's short term storage on the basis that both related to storage facilities and both dealt with excess capacity. This parallel cannot be drawn. First, although both relate to a storage facility, the services being sold are different. Union's proposed service is liquefaction on a just in time basis with storage only on a balancing basis. They are two fundamentally different services and the relationship to storage facilities is a common aspect, but not one that is the fundamental basis of the service in the case of liquefaction.

Second, the capital assets required to provide short term storage are fully rate based and paid for by the customers and there is no incremental capital in addition to that in rate base. However, while there are non-incremental costs associated with liquefaction, the key capital equipment needed to provide the proposed service has yet to be acquired or added to rate base. Union remains fully at risk for that equipment cost. In the case of forbearance, with respect to non-incremental costs, customers are fully compensated for the use of existing assets and services through the cross charge. The customer bears no cost burden.

Third, the short term storage is a service that is independent of the other storage available for in-franchise use. It can be sold and resold without affecting or be affected by in-franchise storage use. Liquefaction for the purposes of Union's proposed service is directly impacted by liquefaction undertaken to provide for Union's system integrity need. This is the interruptible nature of the proposed liquefaction service. Parties, including Board Staff questioned, why the interruptible aspect of the liquefaction service is significant. As noted above, it is the fact that the liquefaction service can be interrupted that allows the system integrity function of Hagar to be ring-fenced and continue wholly unaffected by the proposed service. Other than the allocation of non-incremental costs to the liquefaction service which is to the rate payers benefit, rate payers pay only for the system integrity functions. Therefore, where there is forbearance, the rate payers should not share in revenue where there is no contribution to cost in respect of the non-utility service. Where there is no forbearance, Union remains fully responsible for the costs during the IRM period and there should be no sharing of revenue except in compliance with Board approved Settlement Agreement.

Board Staff asserts that Union's service is effectively firm because of historic system integrity needs. However, this is not the case. For a service to be interruptible it does not need to have frequent interruptions. Interruptiblity is a right that a utility retains to protect utility operations whether it is in respect of liquefaction because of system integrity or for supply in the case of other Union service offerings. That right does not become any less or any greater based on the frequency of interruption. What is important is that the utility has the ability to exercise that right and the customer is at risk of being interrupted. That customer has to consider that risk both economically and operationally. As such, the service is effectively different than Union's short term storage service.

BOMA also relied on the treatment of short term storage on a basis of sharing revenue. For the reasons set out above, BOMA's position should also be rejected by the Board.

D. Nature of the Cross Charge

CME asserts that the cross charge should be an annual fixed charge amount not on a dollar per GJ basis.(CME, p. 8) This proposition should be rejected by the Board. The cross charge is established to recover costs in respect of the use of the asset. As stated above, use is the correct trigger for cost responsibility. For example, if the non-utility business does not use the asset because no GJs are sold then it should not contribute to the cost of that asset.

SEC indicated that while using forecast sales to allocate costs between the LNG and system integrity functions is an appropriate method, SEC asserted that a variance account should be established to account for the recovery of actual costs. However, such a variance account is not required since only actual costs will be recovered from the non-utility business.

E. Conclusion

Based on the foregoing, Union submits that Union is entitled to pursue the proposed service. Its rate design and underlying cost allocation result in just and reasonable rates in the event the board decides not to forbear and the cross charge fully compensates the ratepayer if the Board decides to forbear. Union's proposed sharing of revenue is in compliance with the Board approved Settlement Agreement and with IRM principles in general. As such, Unions proposals and requests should be accepted by the Board.

Union's application was brought for the purpose of ultimately better utilizing a regulated asset. Union has specifically designed its liquefaction service to enable that optimization while at the same time preserving the system integrity aspect of the Hagar facility as a regulated asset. If the Board materially increases the costs above the fully allocated costs as included in Union's application, deviates from the principles of IRM by providing ratepayers with the productivity benefit prior to rebasing or imposes margin sharing, Union will have to reevaluate whether or not it will offer a liquefaction service.

All of which is respectfully submitted by:

Charles Keizer
Torys LLP
Solicitor for Union Gas Limited