



ONTARIO ENERGY BOARD

STAFF SUBMISSION ON SETTLEMENT PROPOSAL FILED ON NOVEMBER 30, 2015

**Union Gas Limited Dawn Reference Price and
North T-Service Application
EB-2015-0181**

December 7, 2015

Background

Union Gas Limited (Union) filed an application with the Ontario Energy Board (OEB) on July 15, 2015 pursuant to section 36 of the *Ontario Energy Board Act, 1998*, for approval to change the reference price used to set commodity rates through the Quarterly Rate Adjustment Mechanism (QRAM) process. Union also requested a new optional North T-Service Transportation from Dawn service to provide customers with access to Dawn-based supply.

In Procedural Order No. 1 dated September 23, 2015, the OEB scheduled a three-day Settlement Conference starting on November 9, 2015, with the objective of reaching a settlement among the parties on the issues. Union filed a Settlement Proposal on November 30, 2015, reaching a settlement on all issues with the exception of one, namely the new optional North T-Service Transportation service.

Union Settlement Proposal

OEB staff has reviewed the Settlement Proposal filed by Union in the context of Union's 2014-18 (Incentive Regulation Mechanism) IRM Framework, other applicable OEB policies, relevant OEB decisions, and the OEB's statutory obligations. OEB staff is of the view that the application and Settlement Proposal is in accordance with the principles established in the QRAM set by the Board for dealing with changes in gas costs in EB-2008-0106 and adequately protects the public interest.

OEB staff supports the proposed Settlement Proposal on the following basis:

- The proposed change to the reference price will better reflect the gas supply portfolio of Union in the future
- The proposed change will reduce the variance between the actual cost of gas and the reference price established in each QRAM
- The detailed cost allocation methodology by zone to set storage and transportation rates for Union North west and Union North East zones will reflect cost causality
- The deferral and variance accounts conform to accounting orders

OEB staff is also of the view that the accompanying explanation and rationale is adequate to support the Settlement Proposal.

OEB staff offers the following commentaries on the proposed change to the reference price.

Dawn Reference Price

Union currently resets gas commodity costs on a quarterly basis under the OEB's QRAM process established in the proceeding on Methodologies for Commodity Pricing, Load Balancing and Cost Allocation for Natural Gas Distributors (EB-2008-0106). Currently, Union's gas supply reference price represents an average cost for gas at Empress (the Alberta Border Reference Price) for the next 12 months.

Union determines the Alberta Border Reference Price by applying a forward Empress basis differential to the future 12-month NYMEX market prices¹, applying a foreign exchange rate and weighting these monthly prices by the volume Union plans to buy in each of the next 12 months. The result is an average cost per gigajoule (GJ) in Canadian dollars that represents the 12-month forward market price at Empress.

Currently, 100% of Union North supply and 40% of Union South supply is sourced from Empress. With conventional production declining in Western Canada and new supplies originating in Northeastern U.S., Union intends to purchase more gas from the U.S. and use Dawn as a critical transportation and storage hub. By 2017, Union forecasts that 85% of Union North customers and 97% of Union South customers will be served predominantly from supply sourced from Dawn or upstream from Dawn. As Union reduces reliance on supply from Western Canada and increases reliance on supply sourced at Dawn, a Dawn Reference Price is a more appropriate market price indicator of the cost of gas supply according to Union.

OEB staff support the use of a Dawn Reference Price as it will be more closely aligned to the actual gas costs of Union going forward. This will reduce the variance between actual and forecasted costs and lead to smaller balances in deferral accounts. It will also result in customer bills showing commodity costs that more accurately reflects the actual cost of gas purchased by Union.

OEB staff notes that Union has not proposed a significant change to the QRAM methodology established in EB-2008-0106. The only change is that Union has proposed to use a Dawn basis to establish the reference price as opposed to an Empress basis.

However, customers in Union's proposed North West Zone (Fort Frances, Union Western Delivery Area and Union Saul Ste. Marie Delivery Area) will continue to be served using Empress sourced supply. Union has proposed to continue using the

¹ The New York Mercantile Exchange (NYMEX) provides future prices of natural gas.

Alberta Border Reference Price to set gas commodity rates for the Union North West Zone as the reference price continues to be an appropriate indicator of the cost of gas. OEB staff support the use of an Alberta Border Reference Price for this zone as it is a better indicator of actual costs.

OEB staff notes that once Union implements its proposal, the QRAM process would use two reference prices: the Alberta Border Reference Price and the Dawn Reference Price. However, OEB staff does not expect this to be an issue as the prices would be separated by zone and the review process is expected to be short and mechanistic as it is now.

Staff further notes that the OEB has recently initiated consultation on gas supply and transportation planning strategies of the gas utilities (EB-2015-0238). Although the outcome of that consultation is not yet known, it is possible that there may be some recommendations relevant to some of the issues addressed in this Settlement Proposal. Depending on the outcome of the consultation, the OEB may choose to revisit some of these issues at a future date.

Cost Allocation and Rate Design Changes

The adoption of a Dawn Reference Price will lead to some changes in transportation costs for Union South sales service customers. As the Dawn Reference Price represents the landed cost of gas at Dawn, no upstream transportation tolls or transportation fuel is required to serve Union South sales service customers. Accordingly, the Union South transportation rate is not required for sales service customers and will be set to zero. However, the transportation line will still appear in customer bills. Union has proposed to keep the transportation rate of zero in the event that future portfolio changes create a need for a Union South transportation rate.

In the Settlement Proposal, Union has agreed to explain the zero transportation rate in its communication materials in order to avoid customer confusion. OEB staff is satisfied with Union's approach to deal with any confusion. When Union does implement this change, OEB staff suggests that Union should be prepared to deal with higher call volumes as customers call in to seek clarifications.

Union's adoption of a Dawn Reference Price will include changes to the gas supply plan. With greater supplies sourced from Dawn, Union will start allocating storage and transportation costs to Union North West and North East Zones. If northern customers

are receiving gas from Dawn, OEB staff submits that they should be allocated the appropriate storage and transportation costs. Union has further noted that the allocation of storage and transportation costs is based on a detailed cost allocation methodology by zone. OEB staff has no concerns with Union's allocation of storage and transportation costs.

In its application, Union has provided annual bill impacts for 2018 as a result of a change in the gas supply plan and the reference price. All zones will see a reduction in gas supply costs with the exception of the Union North Delivery Area. The North Delivery Area will be allocated storage costs of Dawn as Union implements the new gas supply plan but would see a reduction in transportation costs as Union moves from long haul to short haul transportation.

Implementation of Proposed Changes

As a result of the potential delay in TransCanada's King's North Project, parties have agreed that the implementation date will be moved from January 1, 2016 to January 1, 2017. OEB staff support the change in implementation date as Union will not be able to implement changes in the gas supply plan and increase supplies from Dawn if the King's North Project is not complete.

New Deferral Accounts

In its application, Union proposed to establish five new deferral accounts and close certain deferral accounts that would no more be required as a result of adopting a Dawn Reference Price and the proposed changes to the gas supply plan.

In the Settlement Proposal, the parties have agreed to the establishment of four new deferral accounts:

- Transportation Tolls and Fuel – Union North West Operations Area (179-145)
- Transportation Tolls and Fuel – Union North East Operations Area (179-146)
- Union North West Purchase Gas Variance Account (179-147)
- Union North East Purchase Gas Variance Account (179-148)

Union has attached the accounting orders with the Settlement Proposal. OEB staff has no concerns with the accounting orders. There was no agreement on the proposed Base Service North-T Service TransCanada Capacity Deferral Account. As noted

earlier, there was no agreement on the optional North T-Service Transportation and therefore the associated deferral account related to this service remains unsettled.

– All of which is respectfully submitted –