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Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319, 27th Floor
2300 Yonge Street
Toronto, Ontario
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Re: EB-2008-0154 - Union Gas Limited ("Union") – Motion for Review of Board's Decision in EB-2008-0034
Union's Reply to Costs Submissions of IGUA, LPMA, and CME

Dear Ms. Walli:

In its Decision on Motion, dated October 23, 2008, the Board asked parties when submitting their respective costs claims to address the question as to how the costs associated with the motion to review should be accounted for.

Union submits that all of the costs of the motion, including Union's own external counsel costs and the costs awarded to the intervenors, should be included in Union's regulated cost of service and not charged to Union's shareholder.

Under the cost of service model, Union should be allowed to recover all costs prudently incurred to provide utility service. In RP-2001-0032, the Board agreed that a review of prudence involves the following:

- Decisions made by the utility's management should generally be presumed to be prudent unless challenged on reasonable grounds.

- To be prudent, a decision must have been reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made.

- Hindsight should not be used in determining prudence, although consideration of the outcome of the decision may legitimately be used to overcome the presumption of prudence.

- Prudence must be determined in a retrospective factual inquiry, in that the evidence must be concerned with the time the decision was made and must be based on facts about the elements that could or did enter into the decision at the time.

(RP-2001-0032, at para. 3.12.2)

Regulatory costs, including legal fees incurred by the utility and intervenors, are costs that are routinely accepted as necessary in order to provide regulated utility service.

In this case, the fact that only Union's shareholder would have directly benefited if Union's review motion had been successful is not a valid reason to treat the costs of this motion differently than the costs incurred by Union in other regulatory proceedings.

Every proceeding in which a regulated utility seeks to recover costs from ratepayers is a proceeding which directly benefits only the utility's shareholders. Nevertheless, the costs of such proceedings are routinely included in the cost of service because a regulated utility cannot survive economically unless it is able to put forward its case for a fair return. The public indirectly benefits from such proceedings because the public interest is best served when utilities and their investors can be confident that their interests will be given appropriate consideration by the regulator.

Management of the utility companies should be allowed a wide discretion to determine what regulatory issues to bring before the Board, consistent with the normal prudence standard.

The United States Federal Energy Regulatory Commission has summarized the prudence standard as follows:

> [M]anagers of the utility have broad discretion in conducting their business affairs and in incurring costs necessary to provide services to their customers. In performing our duty to determine the prudence of specific costs, the appropriate test to be used is whether they are costs which a reasonable utility management (or that of another jurisdictional entity) would have made, in good faith, under the same circumstances, and at the relevant point in time. We note that while in hindsight it may be clear that a management decision was wrong, our task is to review the prudence of the utility's actions and the costs resulting therefrom based on the particular circumstances existing either at the time the challenged costs were actually incurred, or the time the utility became committed to incur those expenses.

In this case, Union's management concluded that there was reason to doubt the correctness of either the 2007 Deferral Decision or the 2006 Deferral Decision because there appeared to be a contradiction between some parts of those decisions and also with some parts of the NGEIR Decision. The panel which heard Union's review motion disagreed with Union's position. However, Union submits that it was reasonable for Union to seek further clarification from the Board on an issue that directly impacts calculation of regulated rates.

There is no basis for CME's claim that the review motion was brought by Union "in its capacity as the owner of the unregulated storage business". Both the 2006 and 2007 deferral account proceedings dealt with disposition of deferral accounts (including the long term storage margin deferral) to rate classes and customers taking regulated services.

In the 2006 Deferral Decision, the Board found "that the deregulation of Union's storage assets is notionally equivalent to a divestiture, and that any liabilities associated with these assets should properly be associated with Union's newly formed ex-franchise storage service business". Union interpreted that finding to mean that in the future Union was to exclude all costs associated with the unregulated

storage business from Deferral Account 179-72, and that was the basis upon which Union prepared its audited financial statements and calculated Deferral Account 179-72 in 2007 (Union's Reply Argument, paras. 31-32).

In the Decision on Motion, the review panel found that Union's interpretation of the 2006 Deferral Decision was wrong. However, Union submits that its interpretation of the 2006 Deferral Decision was reasonable at the time that the 2006 Deferral Decision was released by the Board. When the Board subsequently released the 2007 Deferral Decision which took a different approach to the calculation of Deferral Account 179-72, it was reasonable for Union to seek clarification from the Board as to the proper method to be used for calculating the long term storage margin that is to be shared with ratepayers taking regulated service.

Union's decision to seek clarification by way of a review motion was not made frivolously. Union brought the motion even though it knew that its shareholder would likely be responsible for most of the costs (even if Union is allowed to include the costs in its regulated cost of service) because the costs were incurred in 2008 while Union is under the incentive regulation methodology. As noted in LPMA's submissions, ratepayers will only bear a portion of the costs of the motion if Union's earnings are sufficient to engage the Earnings Sharing Mechanism. Under Incentive Regulation, the ratepayers may bear up to a maximum of only 50% of the costs, and ratepayers will bear none of the costs unless Union's actual regulated earnings in 2008 are 200 basis points over the amount calculated by the application of the Board's ROE formula (EB-2007-0606, Settlement Agreement, p. 22).

Although the reviewing panel found that Union's motion did not meet the threshold for review, the reviewing panel's Decision on Motion did, in fact, clarify the meaning of the 2006 Deferral Decision and clarify the proper method for calculating the deferral account by expressly stating that the 2006 Deferral Decision "deals specifically and exclusively with the 1997-2006 deferred tax expense" and that "Union can include ongoing costs associated with the unregulated storage business to calculate net revenues". (Decision on Motion, p. 7)

In summary, Union submits that its decision to seek a review of the 2007 and 2006 Deferral Decisions was a reasonable exercise of management's discretion to bring forward to the Board issues that affect the calculation of regulated rates, and the costs of the proceedings should therefore be included in the regulated cost of service.

Union has no objections to the amount of costs being claimed by LPMA, CME or IGUA.

Yours truly,

Sharon Wong

Sharon Wong

sw/maem

c: All Intervenors