IN THE MATTER OF a proceeding initiated by the Ontario Energy Board to determine whether it should order new rates for the provision of natural gas, transmission, distribution and storage services to gas-fired generators (and other qualified customers) and whether the Board should refrain from regulating the rates for storage of gas.

Written Argument of The London Property Management Association And The Wholesale Gas Service Purchasers Group

I - Introduction

This proceeding has involved a number of issues of importance to the London Property Management Association ("LPMA") and the Wholesale Gas Service Purchasers Group ("WGSPG"). These issues included the provision of new services for gas-fired power generators (and other qualified customers), forbearance from the regulation of the rates charged for the storage of gas, Union's proposal for the elimination of the sharing of the associated storage revenues (margins), and Union's proposal to eliminate S&T deferral accounts.

II - New Services for Gas-Fired Power Generators

LPMA & WGSPG's concern on the development of new services for gas-fired power generators and other qualified customers was primarily on the potential rate implications on other customer groups. The Board identified this as an issue in Appendix A of the December, 20, 2005 Notice of Proceeding.

There was a comprehensive Settlement Agreement, in which both LPMA and WGSPG participated, related to a number of issues, including the provision of new services for gas-fired power generators (and other qualified customers). As part of the agreement on the settled issues, there were no identifiable adverse impacts on existing customers. Mr. Kitchen, on behalf of Union Gas confirmed that there would not be any cost allocation issues as a result of the proposals because the incremental services would be paid for by the customers who are going to use them (Tr. Vol. 1, page 49, lines 5-19). This assurance was acceptable to both LPMA and WGSPG. The Board accepted this settlement agreement (Tr. Vol. 4, page 152).

III - Storage Forbearance

a) The Union Proposal

The following is a summary of the Union proposal as understood by LPMA and WGSPG. It is understood that the Enbridge proposal is essentially the same as that of Union.

Union proposes that the Board forbear from regulating storage in Ontario on the basis that there is a workably competitive market for storage. However, Union further proposes that in-franchise customers would continue to receive cost-based rates for storage and the allocation of storage to in-franchise customers would be frozen at 2007 levels. Any incremental storage required by the in-franchise market would be obtained at market-based rates and averaged in with the cost-based rates going forward. This would gradually increase the average cost of storage for in-franchise customers towards a market-based cost, assuming the need for incremental in-franchise storage requirements over and above the 2007 allocation.

Union also proposes to provide high deliverability storage to gas-fired generators (and other qualifying customers) at market-based rates, including those gas-fired generators that are in-franchise customers.

Union further proposes to eliminate revenue sharing with ratepayers associated with long-term peak storage margins and short-term storage and balancing services.

b) Issues Related to Forbearance

i) Storage Development and Forbearance

LPMA and WGSPG submit that are a number of inter-related issues related to the storage development and forbearance in Ontario. These inter-related issues include the need for a different regulatory environment to develop additional Ontario-based storage capacity and deliverability; the treatment of storage owned and operated by regulated utilities, utility affiliates and independent third-party developers; and the treatment of existing storage capacity and deliverability as compared to new storage capacity and deliverability. Finally, there is the issue raised by Union's proposal to eliminate the sharing with ratepayers of the forecast associated with long-term peak storage margins and short-term storage and balancing services.

1) Environment Needed to Develop Additional Ontario Storage

On the first issue, the need for a different environment to develop additional Ontario-based storage capacity and deliverability, LPMA and WGSPG note that in a competitive regional market, such as that espoused by Union, Enbridge, their affiliates and their expert witnesses, there is no guarantee that such Ontario-based capacity will be developed under any scenario. If the potential for additional capacity in Ontario is based on small pools remotely located from other storage and transmission points of access, the cost to bring these additional resources to market may be more than other undeveloped resources in the region. In such a case it may well be that any additional Ontario capacity would only be developed economically after all other lower cost sources within the region are exhausted.

In any event, LPMA and WGSPG submit it is important that developers of new storage capacity and deliverability in Ontario have a level playing field with developers in the region outside of Ontario. That is, if market based pricing is available to storage developed outside of Ontario, then it should also be available to storage developed within Ontario. Only under these circumstances will the market ultimately determine if, when and how much additional storage capacity and deliverability is developed in Ontario. LPMA and WGSPG agree with the numerous parties that have stated that without market based pricing, little or no additional capacity or deliverability would likely be developed in Ontario.

2) Storage Ownership – Utility, Utility Affiliates and Independents

This then leads to the second issue, the treatment of storage owned and operated by regulated utilities, utility affiliates and independent third-party developers. LPMA and WGSPG note that third-party developers of storage capacity and deliverability in Ontario already have market-based rates. They do however, still require the Board to approve a range rate for there services. LPMA and WGSPG believe it is appropriate to remove all Board control over their rates. This would not have any impact on the rates that these developers could charge for storage, but would lighten the regulatory burden on both these companies and the Board.

Similarly, LPMA and WGSPG see no need to regulate the prices charged for storage capacity and deliverability developed by utility affiliate companies. As long as the Board requires the regulated utilities to enforce and disclose such affiliate dealings in conjunction with the Affiliate Relationships Code ("ARC"), then utility ratepayers and independent third-party storage providers should not be disadvantaged relative to one another or to the utility itself. LPMA and WGSPG urge the Board to put in place whatever measures it believes are necessary to ensure that storage capacity and deliverability offered by both affiliated and non-affiliated companies have equal and unfettered access to facilities of the regulated utilities in order to bring their resources to the market.

As for the development of additional storage capacity and deliverability by the regulated utilities, LPMA and WGSPG urge the Board to require these utilities to continue to develop and/or acquire cost-based storage and deliverability where there is a need for additional storage from in-franchise customers and it is economic for the utilities to do so. In the current situation, Union has excess storage capacity compared to that required by in-franchise customers. However, Union may need to develop additional deliverability (including high deliverability) for in-franchise gas-fired generators. As argued below, any deliverability required by in-franchise customers should be available through the utility at cost-based rates if it is economic for the utility to develop this capacity.

LPMA and WGSPG also submit that the Board may want to assess whether it is appropriate for the regulated utilities to develop any additional storage for ex-franchise purposes. Both utilities have argued that storage for ex-franchise customers that is sold at market-based rates is a risky venture. The amount of capital required, the lack of assurance that storage development costs always result in a working storage reservoir, and the volatility in gas prices (Tr. Vol. 3, pages 151-152) mean that storage development for sale in a competitive market is riskier than the distribution business, including the historical development of storage required for in-franchise customers that will remain at regulated rates. If both activities are undertaken in the same company, it may be difficult to evaluate the impact on the regulated portion of the business in terms of the cost of and ability to attract capital. Ratepayers should not be subsidizing risky ventures and providing Union with an advantage over independent third-party developers in terms of access to and costs of financing such projects.

Mr. Baker stated (Tr. Vol. 3 pages 152-153) that it was Union's view that it is in the business (of developing storage) and they would like to continue to be in it. LPMA and WGSPG submit that Union is in a regulated business and that it does not need to be in the business of developing storage for sale in a competitive market. As Union and Enbridge have noted, they both have affiliates which are already in that business.

<u>3) Existing Storage vs. New Storage</u>

This brings us to the third issue, the treatment of existing storage capacity and deliverability as compared to new storage capacity and deliverability. As indicated above, LPMA and WGSPG believe that new storage capacity (and deliverability) should be allowed to develop without regulatory oversight on the prices that can be charged for utility affiliates and independent third-parties. New storage development by regulated utilities should be limited to that needed for in-franchise purposes and should be at regulated cost-based rates.

As Mr. Kaiser pointed out (Tr. Vol. 10, page 28) the re-pricing of existing capacity and deliverability is a separate issue. In the case of Union Gas, the existing capacity and deliverability is used for both in-franchise and ex-franchise customers. LPMA and WGSPG submit that the Board should maintain the status quo for all existing storage capacity and deliverability. There has been no evidence provided by any party to suggest that forbearance on any of the existing regulated assets of the utilities is a necessary condition for additional storage to be developed in Ontario. In fact, the vast majority of utility owned storage assets will remain regulated under their proposals. Only a portion of the regulated storage assets owned by Union would be subject to forbearance. As indicated above, no party has provided any evidence that a lack of forbearance on the part of the Board on this portion of Union's storage assets will have any negative consequences on the development of new storage facilities in Ontario.

If forbearance on this portion of Union's assets is not necessary to stimulate storage development in the province, then the question is why should the Board forbear from regulating these assets? The only reason, of course, is for the transfer of profits from ratepayers to the shareholder of the utility. LPMA and WGSPG submit that the Board should reject this proposal.

The storage assets that have been developed by Union, including that portion over which Union now seeks forbearance, were developed under a regulatory compact with its ratepayers. In the absence of any valid public policy need, there is no just and reasonable rationale for Union or any other regulated utility to build up assets under the auspices of regulation and then remove those assets from regulation for their own profit.

The submission of the LPMA and WGSPG with respect to these forbearance issues closely parallels the recent Federal Energy Regulatory Commission ("FERC") Order No. 678. This order was discussed by Mr. Stauft and Mr. Kaiser (Tr. Vol. 10, pages 26-29). FERC essentially allowed market pricing for new facilities to ensure that facilities that may have higher marginal costs than existing facilities can be economically developed. FERC did not, however, give the owners of existing regulated facilities the right to market-based pricing. The goal was to help the developers of the marginal pools. Giving market-based pricing to existing facilities would not help the developers of marginal pools and simply does not make sense.

4) Elimination of Margin Sharing

The elimination of the forecast margin sharing is the final issue in this section. On the Union system, the existing storage capacity and deliverability is first allocated to the needs of the in-franchise customers and provided at cost-based rates to those customers. Any excess is then available to be sold to ex-franchise customers at market-based rates. The margin from this excess was then shared 90:10 in favor of ratepayers (RP-2003-0063 Decision with Reasons dated March 18, 2004, page 67). Any variance from the forecast is captured in a deferral account and the balances (both positive and negative) are shared between ratepayers and the shareholder on a 75:25 basis.

In the 2007 rates cases, (EB-2005-0520) Union proposed to include the total forecast of S&T transactional service revenues (margins) and the long-term storage premium in the determination of rates, consistent with the treatment of all other forecast revenue. This means that the entire long-term storage market premium would be allocated back to in-franchise customers. This proposal would be superceded by the outcome of the current proceeding. Also, in the 2007 rates cases, Union proposed to eliminate the deferral account.

ii) In-Franchise Storage

There are three issues related to in-franchise storage dealt with in this portion of the argument: the pricing of in-franchise storage, the allocation of storage to in-franchise customers and the entitlement to cost-based storage for in-franchise customers.

1) Pricing of In-Franchise Storage

Both Union and Enbridge are proposing that in-franchise customers continue to receive storage at cost-based rates. There is no evidence to support moving in-franchise customers to market based rates. There is also no evidence that would suggest that storage development in Ontario would be adversely affected by keeping storage required for in-franchise use at cost-based rates. LPMA and WGSPG support the retention of the status quo with respect to storage pricing for in-franchise customers. As Mr. Baker pointed out, customers have opted to take a bundled service that includes storage (Tr. Vol. 4, page 74). It does not make sense to force customers off of this service just to try to force a competitive market for storage onto these customers.

2) Allocation of Storage to In-Franchise Customers

The LPMA and WGSPG argument on this matter deals specifically with the Union Gas proposal. Union proposes to fix the amount of storage available to in-franchise customers at the 2007 level. Any additional storage requirements for in-franchise customers (because of customer growth, change in consumption patterns, etc.) would be obtained at market-based prices and the cost would be rolled in with the cost-based storage (Tr. Vol. 4, page 118). Over time, assuming a need for incremental storage for in-franchise customer use, this would gradually move the cost of storage for in-franchise customers away from a cost-based priced towards a market-based price.

LPMA and WGSPG oppose this proposal and submit that Union should be required to continue with its existing methodology of first allocating its existing storage assets to in-franchise customers. Amounts in excess of this need are then available for the ex-franchise market (Tr. Vol. 3, page 159).

Union starts out with the proposition that in-franchise customers require the protection of regulation. Union also states that the requirement for incremental storage for in-franchise customers has not been a significant amount (Tr. Vol. 4, page 76). The question is therefore, as expressed by Mr. Kaiser, why wouldn't Union simply continue supplying it on the existing basis? In reply to Mr. Kaiser, Mr. Baker indicated that it certainly was an option that was open to the Board (Tr. Vol. 4, page 76-77).

Union's rationale for its proposal seems to be two fold: the incremental in-franchise storage requirement is likely to be small and it wanted to ensure that new third-party providers would have an opportunity to serve incremental in-franchise growth. Neither of these reasons stands up under scrutiny. If the incremental in-franchise storage requirement is small, it would not be a problem for Union to continue to allocate its storage space first to these customers. It is not going to run out of space for ex-franchise customers any time soon. Further, if the growth is small, it will not be a significant factor in the development of third party storage either. Moreover, third party storage providers would develop storage for the market, not for a segment of the market.

Union's proposal does not affect the overall need for storage. A simple example illustrates this point. Suppose that the incremental in-franchise storage requirement is 2 bcf. Under Union's proposal this 2 bcf would be purchased at market, possibly from third-party providers. Under the existing methodology, this 2 bcf would be supplied by Union, who then, by definition, would have 2 bcf less for the ex-franchise market. This 2 bcf shortfall could be provided by the third-party providers. The net impact on the market is an increase in demand of 2 bcf in both cases. Since third-party providers are unlikely to care which part of the market they are providing the additional storage to, Union's proposal is not necessary to encourage the development of third-party storage.

From a ratepayer point of view, the Union proposal is nothing but a way to make off with more profits at the expense of customers. Union has developed, under the auspices of regulation, more than sufficient storage resources to serve in-franchise customers. These customers have a right to expect that the utility will continue to use whatever portion of these assets required to serve them at regulated rates. Now Union wants to arbitrarily take a portion of that resource away from these customers and subject them to market based prices on any incremental requirements they may have. LPMA and WGSPG submit there is no logic in doing this.

If, for some reason, the Board were to approve Union's proposal to impose market-based pricing for incremental storage requirements on ratepayers, then LPMA and WGSPG submit that a number restrictions should be placed on the operation of such a methodology. First, any incremental storage acquired by the utility for in-franchise customers should be from true third-party providers. That is, affiliates should not be allowed to compete for this storage. If the utility develops additional storage or deliverability and plans to use this capacity for incremental in-franchise requirements, it must demonstrate that the cost is no greater than that which could have been obtained from a third-party. Finally, if the amount of storage required by in-franchise customers in the future is less than the cost-based amount allocated based on 2007 (due to slow customer growth, demand side management programs, economic downturns, etc.), then Union must be required to actively market this storage and return all revenues associated with it to in-franchise customers.

The difference between the Union proposal and the current methodology is illustrated as follows. Under the current methodology, 2007 storage requirements are set as part of the cost-of-service filing. Any change in in-franchise requirements over the succeeding incentive regulation period would have to be managed by Union. At the end of the incentive regulation period, the in-franchise storage requirements would be recalculated based on the cost-of-service/rebasing evidence filed at that time. Union's proposal would have the identical results, except that the amount of storage allocated to in-franchise customers would be fixed and would not be recalculated based on information at the end of the incentive regulation period. As Mr. Baker stated, the change in the amount of storage required for in-franchise customers is likely to be small. However, over a number of years, such as an incentive regulation period, the impact could be substantial, especially given the potential difference between cost-based and market-based prices in the future. LPMA and WGSPG urge the Board to continue to protect ratepayers by ensuring that assets that are already developed and in service continue to be used to service all in-franchise customer storage needs. That is, the Board should direct Union to continue with its existing methodology that allocates sufficient storage to in-franchise customers first.

3) Entitlement to Cost-Based Storage for In-Franchise Customers

A separate issue that has arisen is the need for storage for in-franchise gas-fired generators (and other qualified customers). These customers require high deliverability services that are currently not available. The utilities propose to develop and/or purchase this capability and provide it to these customers at market based prices.

LPMA and WGSPG submit that the utilities should be providing this service to the customers the need or want it at regulated rates. The utilities have an obligation to serve the needs of its in-franchise customers (subject to economic feasibility). The utilities should be directed to provide the service that these customers (or for that matter, any customer) require at the least cost possible. This may entail the utility developing these services and earning an approved return on them, or purchasing such services from other providers if the service is available at a lower cost than if the utility developed the service itself or if the utility does not have the capability to provide such a service.

As part of being a regulated entity, the utility has entered a social contract and has accepted an obligation to serve all customers who want service, providing that it is economically viable and in the public interest to do so. LPMA and WGSPG see no logic in discriminating against one type of customer as opposed to another. Union already has cost-based storage for residential customers in their Southern Operating area that is based on a combination of Standard Storage Service at 1.2% deliverability and Standard Peaking Service at 10% deliverability (Exhibit K.7.1). Why should it not do the same for other rate classes at cost-based rates?

iii) Long-Term Storage Market Premium

Union currently forecasts a long-term storage market premium that is shared with ratepayers. Any variance from that forecast is captured in a deferral account and shared with ratepayers as well. Union is proposing to eliminate all sharing and move the storage assets associated with providing ex-franchise services to an unregulated portion of the company.

If the Board determiners that it should forbear from regulating storage for some or all ex-franchise customers and that these assets should be removed from the regulated rate base and that the associated costs and revenues should be removed from the revenue requirement, then LPMA and WGSPG submit the Board needs to consider a number of additional issues.

First, the issue of the allocation of rate base and costs needs to be addressed and reviewed, despite the submissions of Union Gas that this has effectively been done. This issue is dealt with in more detail under the Allocation Issue below.

Second, the Board should initiate a review process to deal with the implications of the removal of assets from regulation for the sole benefit of the shareholder. These assets were developed by Union under a framework of regulation. As noted on page 5 of the Argument of the City of Kitchener filed on August 11, 2006, the Board stated in the EBRO 410-II, 411-II and 412-II decision dated March 23, 1987 (also found at page 9 of Exhibit J1-12.2 in this proceeding) that regulation involves a social contract and that according to this social contract theory, the regulated firm agrees to charge just and reasonable prices and to forego windfall profits. Union will reap windfall profits if it is allowed to pocket all of the long-term storage market premium. Union's proposal to separate regulated assets into regulated and unregulated assets without any compensation to ratepayers or any further sharing of the market premium effectively violates the social contract under which these assets were developed. While it is clear that ratepayers do not own the assets, the environment under which they were developed provided the utility with a stable return on these assets.

Third, The Board will need to determine whether the storage assets in Ontario should be priced at cost for all Ontario ratepayers, including those served by Union's ex-franchise customers Enbridge Gas Distribution Inc. and Kingston Utilities. LPMA and WGSPG defer to the August 11, 2006 Argument of the City of Kitchener on this matter and submit that this issue should be fully addressed in the Board's decision, regardless of what that decision ultimately is.

In summary, LPMA and WGSPG submit that if Union is allowed to keep all margins from the sale services generated by assets that are deregulated, then the regulatory contract under which those assets were developed has been broken and ratepayers should be compensated accordingly. LPMA and WGSPG submit that one way to compensate ratepayers is to incorporate the long-term storage market premium forecast by Union for 2007 into rates each year thereafter. This effectively locks the value of this storage asset into future ratepayer rates and provides the utility with the opportunity to maximize and manage any change in the value of these assets that takes place after their removal from regulation.

iv) Short-Term Storage and Other Balancing Services

These services consist of short-term peak storage, off peak storage, balancing and loan services and the Enbridge LBA. These services are provided by Union using utility assets that are surplus to the needs of in-franchise customers from time to time (Tr. Vol. 3, page 118). This will continue to be the case under Union's proposal, as the assets required for in-franchise customers will continue to be regulated utility assets. However, Union proposes to keep all of the proceeds associated with the utilization of these regulated assets for all revenues generated from the ex-franchise market (Tr. Vol. 2, pages 139-141).

LPMA and WGSPG submit that there is no valid rationale for the utility to keep all of the revenues and/or margins associated with the services that are made possible through the use of regulated assets simply because they can be sold in a competitive market (Tr. Vol. 2, pages 139-140). In the past the Board approved a sharing mechanism because it would encourage Union to develop its storage assets and it would maximize the use of these assets (Tr. Vol. 3, page 119).

Indeed, in the view of LPMA and WGSPG, there is a question as to whether the utilities should be allowed to keep ANY of the proceeds of such transactions. Union has characterized the assets that will be used for in-franchise storage requirements as remaining as regulated assets (Tr. Vol. 2, pages 138-139). Mr. Baker also agreed that the Board determines a reasonable return allowance on those assets deemed to be providing regulated service and that no supernormal returns are allowed in the cost-service progress in that the reasonable return determined by the Board is the basis of the rates that are determined (Tr. Vol. 2, page 103).

In essence, Union was paraphrasing the Bluefield Water Works decision about return. The relevant portion of that decision is as follows:

"A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures."

When asked about this particular decision, Mr. Smead, an expert witness on regulatory issues (Tr. Vol. 6, pages 2-7), agreed with Mr. Thompson that a utility is not entitled to a supernormal return on its utility business (Tr. Vol. 7, pages 65-66). When defining utility business, Mr. Smead indicated that which assets were involved in the utility business was a question for the regulator. LPMA and WGSPG submit that the answer is simple and straight forward. The utility business for regulatory purposes is the regulated business that the utility carries on, including the provision of storage to in-franchise customers. The provision of this service involves the use of certain storage and storage related assets that the utilities propose to remain as regulated assets. Union's proposal, therefore, enables them to recover the reasonable return on these assets from in-franchise customer through cost-based rates and pocket all other revenues generated by these assets, thereby earning higher returns on those assets.

As noted earlier, regulation involves a social contract that in effect states that firms agree to forego windfall profits. Union's proposal violates this social contract.

Another expert, Professor Schwindt, characterized the return of the premium generated through the efficient use of these assets as a subsidy to in-franchise customers (Tr. Vol. 3, pages 154-155). However, Professor Schwindt appeared to be confused on this issue. When asked by Mr. Janigan about the regulatory contract in that ratepayers pay rates to acquire the assets and then the utility is supposed to use those assets in a way that benefits the ratepayers, Professor Schwindt indicated that this was the issue because the only way that ratepayers could get the benefits was by consuming more gas and that this is not efficient. Professor Schwindt then goes on to indicate that a consumer that uses very little gas gets very little benefit while a large consumer gets more of the benefit and is therefore being subsidized. This is wrong. The amount of gas consumed does not determine who receives the benefit. The benefits are allocated to in-franchise customers in the Southern Operations area among rate classes in proportion to their design (peak) day demand and in the Northern and Eastern Operations area among rate classes in proportion to the storage demand costs. Therefore, the benefits are related to use of storage, not to volumes consumed. As such, large volume customers with a high load factor are not being subsidized by small volume customers with a low load factor. In fact, the benefits are being allocated back to customers in the same exact proportion as the customers pay for storage in their rates.

Professor Schwindt also indicated that if a utility has some assets that are not being used in a particular period, it has an obligation to minimize the net costs to ratepayers. In particular, he stated that (Tr. Vol. 3, page 175):

"The utility has an obligation to minimize the net cost to ratepayers? Yes, I suppose it does, and through the efficient operation of the facility.

I mean, what gets murky here is this whole issue of ownership of these assets, right, as to who actually is owning. I don't really think it makes much difference there, that the -- what we should be trying to do is to use those assets as efficiently as possible, and if someone has a question as to who should be getting the benefits of that - in other words, charging the higher price or whatever else - that really is a distributional issue; right? It's not an efficiency issue."

As noted above, Professor Schwindt also touched upon the distributional issue. In the submission of LPMA and WGSPG, this harkens back to the Bluefield Water Works case above. In reply to a question from Ms. Chaplin, Professor Schwindt stated (Tr. Vol. 4, page 136):

"I have to stick with my high-level observation, that is, clearly the utility should not be maintaining idle capacity that they're charging off to the ratepayers. So if there is idle capacity, they should get rid of it and reduce the costs that are being borne then by the ratepayer."

LPMA and WGSPG submit that by selling the "idle capacity", i.e. short-term peak storage, off peak storage, balancing and loan services that are available and that use assets that have been allocated to the in-franchise customers and remain regulated, the utility is indeed reducing the costs that are being borne by the ratepayer, but only if the additional revenue is allocated to rate payers and used to reduce the net costs to them.

The remaining question is what incentive does the utility require to ensure that it does indeed maximize the value of these assets for ratepayers? In the 2007 rates proceeding, Union proposed to allocate 100% of the forecasted margin to ratepayers and to share any variance from this forecast between ratepayers and the shareholder. LPMA and WGSPG submit that this mechanism should be continued for 2007. The need for a deferral account in 2008 and beyond is discussed in Part IV – S&T Deferral Accounts below. In either case, with or without a deferral account, Union would have an incentive to maximize the value of this regulated resource. They would continue to receive a percentage of the variance between the forecast and the actual value. In the absence of a deferral account, that percentage would be 100%. Union would have an incentive to achieve the forecast level as a minimum. Otherwise the shareholder would absorb a portion or the entire shortfall. Anything above the forecast level would accrue, at least in part, to the shareholder.

Finally, there are dichotomies in the Union proposal that cannot be justified. First, Union makes a distinction between regulated storage and regulated transportation with regards to how the proceeds are allocated. Union's proposal continues to include the forecasted revenues associated with transportation and exchange services (account 179-69) as an offset to the revenue requirement for regulated services. However, they would not include the forecasted revenues associated with short-term storage and balancing services (account 179-70). Both revenue streams (transportation and storage) are, and will continue to be, made possible through the use of regulated assets required for the delivery of regulated services. The only distinction offered by Union to explain the different treatment of the forecasted revenues generated by the two services is that the storage component can be sold in a competitive market. LPMA and WGSPG submit that this is not a sufficient justification for confiscating the additional profits from ratepayers. Union should not be allowed to generate additional profits on the backs of ratepayers.

Second, Union proposes to keep all the profits from capacity that has been assigned to ratepayers when the opportunity arises to market idle capacity, but also proposes that the amount of capacity allocated to in-franchise customers be fixed at 2007 levels and that any additional capacity required to serve these customers in the future be priced as market based rates rather that cost based rates. This is a double slap in the face of ratepayers. No only do they not benefit as a result of idle capacity for which they have paid, but they have to pay higher rates for additional capacity they may require.

<u>v) The Allocation Issue</u>

If the Board determiners that it should forbear from regulating storage for some or all ex-franchise customers and that these assets should be removed from the regulated rate base and that the associated costs and revenues should be removed from the revenue requirement, then LPMA and WGSPG submit that the allocation issues should be addressed with the benefit of a full evidentiary base as part of the 2007 rates determination. In the case of Union Gas, their main rates proceeding has been completed, but remains open to adjust for impacts that arise from this proceeding and from the Generic DSM proceeding. As a result there is no impediment of fully examining the allocation issues that will be raised as a result of splitting the utility into regulated and non-regulated components in time for 2007 rates to be put in place prospectively.

In their Argument, Union states, at page 4, that:

"There is no need for another proceeding to determine the allocation of costs and revenues. The allocation can be based on the 2007 cost study filed in Union's most recent rate case and accepted by the Board for determining 2007 rates in EB-2005-0520."

LPMA and WGSPG submit that this is not the case. Indeed, Union's witness, Mr. Baker, clearly indicated that Union would need to do a cost allocation to split the assets, costs and revenues between the regulated and non-regulated portions of the company as illustrated in the following exchange with Mr. Thompson (Tr. Vol. 2, page 117):

MR. THOMPSON: *All right. But in words, what are the assets that you say come out, the assets that supposedly are supporting the exfranchise storage business? How do you determine what they are?*

MR. BAKER: *It would be an allocation of the current storage assets that we have today. So we have a block of storage assets today that supports the combined business, infranchise and exfranchise, and* ***we would need to do a cost allocation to split that*** *(emphasis added).*

MR. THOMPSON: *And when will we be doing that, if you get what you're after?*

MR. BAKER: *After we got a Board decision,* ***we would undertake to do that work and to file that material and that calculation*** *(emphasis added).*

In a response to Mr. Warren who was following up on this response, the witness provided the following (Tr. Vol. 3, page 130):

MR. BAKER: *It wouldn't -- there may be a separate phase of this case. I would have to look at how that would actually happen, but first we would require a decision from the Board in this case to approve forbearance, and then we would look at the allocation of the revenues and the costs and the rate base in order to do that elimination from the current utility cost of service.*

Clearly Union expects that it will have to file additional evidence dealing with its cost allocation material and its calculation to determine what component of rate base, costs and revenues should be eliminated from the regulated portion of the company.

Union states in their Argument (page 4) that the cost allocation necessary to determine the appropriate allocation of assets to ex-franchise sales has already been completed. LPMA and WGSPG submit that this is not the case for a number of reasons.

First, the Board and intervenors should be afforded the opportunity to review and examine the methodology used to allocate assets and costs between the regulated portion and the non-regulated portion of the company. Parties have not had the opportunity to fully review the allocation of the assets and costs to ex-franchise rate classes. A review of EB-2005-0520 Procedural Order No. 3 dated March 22, 2006 shows that the attached approved issues list did not include any issues related to the allocation of storage and storage related assets and costs between in-franchise and ex-franchise rate classes. Further, as Union proposed to include 100% of the long-term market premium and the short-term transitional storage market premiums in the determination of rates, any review of the allocation of assets and costs to the different rate classes would not have made any difference on the revenue requirement. This is because if some amount of costs were shifted from in-franchise customers to ex-franchise customers, the resulting ex-franchise margin, all of which is ultimately allocated back to in-franchise customers, would have been lower, exactly offsetting the lower costs allocated to in-franchise customers. Shifting costs from ex-franchise customers to in-franchise customers would have had the same net impact, i.e. none.

Second, LPMA and WGSPG submit that it is not clear at this point that the allocation methodology used to allocate costs between rate classes is necessarily the proper methodology to allocate costs between regulated and non-regulated activities. The issue of whether the total current storage and storage-related assets should be allocated on a rolled in basis, on an incremental basis or on some other basis, has not been examined in either the current proceeding or in Union's 2007 rates proceeding. For example, a fundamental question here is whether the assets and costs that Union proposes to allocate to in-franchise customers should include more recent assets that presumably have increased the overall average cost of storage to these customers. Clearly these additional storage assets were developed for use by ex-franchise customers as Union had more than sufficient storage for its in-franchise customers. Is it just and reasonable for these in-franchise customers to continue to bear costs, a portion of which are directly attributable to the development of assets that are to be taken out of regulation, for the sole benefit of the shareholder? It is the submission of LPMA and WGSPG that it is not. It is, in fact, a subsidy being paid for by in-franchise customers since the actual incremental cost of the storage that would be allocated to ex-franchise non-regulated services has not been totally removed from the remaining regulated costs.

Third, Union has provided an estimate of the storage rate base that would be removed from regulation in Undertaking K4.3. However, LPMA and WGSPG submit that there may well be other rate base assets that should be removed from the regulated portion of the company to reflect the removal of ex-franchise storage from regulation. As a simple example, the operators of the storage presumably use offices, office equipment, computers, software and so on. The marketers of this ex-franchise storage would, in all likelihood, also use such assets. An allocation of these assets should also be removed from the regulated rate base. The removal of certain costs, revenues and associated GST would also have an impact on the working cash component of rate base. All of this needs to be fully investigated before the Board can determine what should be removed from rate base and the overall revenue requirement of the regulated portion of the utility.

Fourth, there is the issue of the allocation of risk, which Union has failed to address in this proceeding. Union's position on the Return on Equity in this proceeding is clear. Mr. Baker stated that:

"under forbearance, the assets that remain under regulation would earn a return commensurate with what the Board determined under what it is today, under the formula ROE" (Tr. Vol. 2, page 116).

LPMA and WGSPG submit that the creation of regulated and non-regulated portions of the utility require the review of the allocation, or division, of risk between these two new entities. Union has stated that storage is valued based on seasonal commodity prices and that gas prices are volatile (Tr. Vol. 2, page 126). This volatility is so large that the value of storage has gone from negative numbers to more than three times that of cost-based storage (Tr. Vol. 2, pages 121-122). Clearly storage is a riskier business than distribution.

This conclusion is supported by Union's expert witnesses, the Brattle Group, in the 2007 rates proceeding, where it was concluded that "*if Union Gas' storage and transportation assets were separated from its distribution assets, then Dr. Carpenter would conclude that Union Gas' storage and transportation assets are more risky than its distribution assets"* (Exhibit J14.75) and that it was *"Dr. Carpenter's opinion that a key factor distinguishing Union from the portfolio of U.S. LDC's employed by Dr. Vilbert is the competitive exposure of Union's transportation and storage business"* (Exhibit J14.76). The referenced interrogatory responses have been attached to this Argument in Appendix A.

It is clear to LPMA and WGSPG that with the removal of a significant portion of the storage assets from the regulated rate base, indeed the very portion of the storage assets that are subject to significant price and value volatility, a review of or an adjustment to Union's return on equity and/or equity component of rate base needs to be undertaken. The removal of more than $100 million in rate base (Undertaking K4.3) and additional costs, is a significant change in the environment in which these parameters should be evaluated and determined. As Dr. Carpenter stated in the response to Interrogatory J14.75, *"Union Gas' storage and transportation assets cannot be looked at separately from its distribution assets in evaluating Union Gas' business risk. An equity investor invests in both the storage and transportation assets and the distribution assets of Union Gas."*

The Board has determined a capital structure and return on equity based on the existing structure of Union as a regulated service provider. Moving a portion of the higher risk business to an unregulated part of the business should mean that the remaining regulated business has less risk, meaning an adjustment to the capital structure and/or return on equity on the remaining regulated business is required.

LPMA and WGSP submit that all of the preceding needs to be fully investigated before the Board can determine what should be removed from rate base and the overall revenue requirement of the regulated portion of the utility in order to determine just and reasonable rates for the remaining regulated services.

vi) Rate Mitigation

If the Board ultimately determines that it should forbear from regulating storage for some or all ex-franchise customers in whole or in part and further determines that the revenue sharing that currently exists for the long-term peak storage margins and/or short-term storage and balancing services should be terminated as proposed by Union, then LPMA and WGSPG submit that the Board should mitigate the impact on ratepayers by phasing out the revenue sharing with customers from these activities over a number of years.

In order to determine a proper phase-out period, LPMA and WGSPG propose the following approach. The loss of the revenue sharing would total over $26 million to the M2 rate class as compared to the status quo (Tr. Vol. 2, pages 114-115). The M2 delivery volume for 2007, as taken from Exhibit C3, Tab 2, Schedule 1, Addendum in EB-2005-0520, is 3,962,767 10^3 m^3 or approximately 148,000,000 GJ. The loss of revenue sharing therefore equates to approximately 17.5 cents/GJ ($26 million / 148 Million GJ). Mr. Baker, on behalf of Union, correctly points out that that this estimate is based on the value of storage at a particular point in time and that there is no certainty that the same level will continue into the future (Tr. Vol. 2, page 116). However, LPMA and WGSPG submit that this is the only value on the record in terms of the additional cost to an M2 customer. The value of storage does fluctuate, but in the future it could be higher or lower than the current value. The estimates above are based on the best information currently available and built into the 2007 revenue requirement.

The question then becomes how big of an impact this is on customers and what is an appropriate timeframe to phase in the transition to no revenue sharing. LPMA and WGSPG submit that the Board should look to the RP-2002-0130 Decision with Reasons dated May 8, 2003 for guidance. The relevant issue in that proceeding was the elimination of the Delivery Commitment Credit ("DCC").

The DCC was paid for obligated deliveries to direct purchase customers. The DCC paid was $\$4.25/10^3\ m^3$ or approximately 11.3 cents/GJ. In its findings on this topic the Board stated (at paragraph 270 of the RP-2002-0130 Decision with Reasons) that:

"The Board is concerned that the elimination of the programme in one stroke could unduly disrupt the business planning and budgeting activities of some DP customers. Such customers have developed a reliance on the current rebate structure, and they should be afforded a reasonable opportunity to accommodate a new context that does not include any element of incentives related to their compliance with their contractual obligations to deliver at a negotiated delivery point. Accordingly, the Board will provide for the proportionate phasing out of the DCC programme over a period of five years. Union is directed to develop the rate schedules reflecting this aspect of the Board's Order and to provide the same to Board Staff and Intervenors."

LPMA and WGSPG submit that the elimination of the current revenue sharing mechanism is analogous to the above. Clearly, the Board was concerned about the impact on costs to customers. By eliminating the DCC, costs would increase to direct purchase customers. By eliminating the revenue sharing mechanism, costs will increase to ALL customers. As a result, it is just as, if not more, important for rate mitigation measures to be adopted as a result of this proceeding. LPMA and WGSPG further submit that the phase-out period should be set at eight years. This is simply an extrapolation of a five year mitigation period that the Board required for an impact of 11.3 cents/GJ to reflect a total cost of 17.5 cents/GJ, rounded to the nearest year.

c) Summary of Recommendations on Storage Forbearance

- Prices charged for independent third-party shortage should not be regulated.
- Prices charged for utility affiliate storage should not be regulated. The affiliate relationships code (ARC) should be adequate to ensure independent third party storage providers and utility ratepayers are not disadvantaged.

- The status quo for all existing storage and deliverability that has been developed under a regulated environment should be maintained. That is, the storage and deliverability is first used to serve in-franchise customers with any excess sold at market based rates with any premium shared with ratepayers.
- Any additional storage and/or deliverability developed by regulated utilities should be used, if needed, for in-franchise customer requirements and should be cost-based.
- In-franchise storage should remain at cost based rates.
- The allocation of storage to in-franchise customers should continue to be adjusted with cost of service/rebasing filings.
- All in-franchise customers all entitled to storage services required at cost-based rates, including gas fired generators with high deliverability requirements.
- If the Board decides to forbear from regulating storage in whole or in part, then the forecast long-term storage market premium should continue to be shared with ratepayers.
- If the Board decides to forbear from regulating storage in whole or in part, then Union should be directed to continue to optimize the value of and allocate all forecast margins associated with short-term storage services and off peak storage/balancing and loan services to in-franchise customers.
- If the Board decides to forbear from regulating storage in whole or in part, then the Board should direct parties to review the allocation of rate base, costs and revenues between the regulated and unregulated components of the company. The Board should also direct parties to review the potential impact on the return on equity of removing a portion of the currently regulated assets from rate base. This review should be done as part of the 2007 rate cases for Union and Enbridge.
- If the Board decides to forbear from regulating storage in whole or in part and determines that the revenue sharing that currently exists for the long-term peak storage margins and/or short-term storage and balancing services should

be terminated, then this impact on customers should be phased in over an eight year period.

IV - S&T Deferral Accounts

a) The Union Proposal

Union proposes to eliminate five S&T deferral accounts (Tr. Vol. 1, pages 66-67):

- Short Term Storage and Other Balancing Services deferral account (179-70)
- Long Term Peak Storage Services deferral account (179-72)
- Transportation and Exchange Services deferral account (179-69)
- Other S&T Services deferral account (179-73), and
- Other Direct Purchase Services deferral account (179-74).

These accounts are defined in Union's 2007 rates evidence (EB-2005-0520) at Exhibit D1, Tab 5, Appendix A, pages 3-4. These pages are included in Appendix B to this Argument for ease of reference.

The first two of these accounts (179-70 & 179-72) would no longer be required under Union's proposal because the underlying revenues generated would be to the account of the shareholder and not to ratepayers. Any variance from that would then be irrelevant.

The last three accounts (179-69, 179-73 and 179-74) would be eliminated, but the underlying revenues that were forecast would continue to be included in the rates-making process, consistent with the treatment of all other regulated revenues (Tr. Vol. 1, pages 67-68). The rationale put forward by Union for the elimination of these three accounts is two fold. First, there is no reason to treat these revenues any differently than any other revenue stream. Second, the elimination of these deferral accounts is consistent with the Board's policy direction as outlined in the NGF report dated March 30, 2005. The Union witness agreed, however, that any discussion on what any incentive regulation regime would look like has yet to be had (Tr. Vol. 3, pages 125-126).

b) Treatment of S&T Deferral Accounts

LPMA and WGSPG agree with the premise that if there is no revenue sharing from the underlying activity, then there is no need for an associated deferral account. LPMA and

WGSPG do not, however, agree with the elimination of the accounts based on there being no reason to treat these revenues any differently from other revenues streams or on the basis of the policy direction in the NGF report.

The following sections deal with the five S&T deferral accounts that Union proposes to eliminate.

i) Transactional Transportation Related Services

The accounts dealt with in this section include:

- Transportation and Exchange Services deferral account (179-69)
- Other S&T Services deferral account (179-73), and
- Other Direct Purchase Services deferral account (179-74).

As part of the EB-2005-0520 rates proceeding, Union Gas proposed to include the total forecast revenues (margins) for related to these transactional services in the determination of rates, consistent with the treatment of all other forecast revenues (Exhibit C1, Tab 3, page 23). This eliminated the margin sharing associated with the forecast. Union also proposed to eliminate the margin sharing associated with any variances from forecast.

As noted above, the first rationale for this elimination is that there is no reason to treat these revenues (margins) any differently than any other revenue stream. This is not the case. These variance accounts reflect the fact that Union has had a poor track record in forecasting these margins in the past. In their Argument, Union states that it ***"has concluded that the revenue derived from these services can be forecast as accurately as any other revenue"*** (Union Gas Argument dated August 11, 2006, page 21). There is no evidence in this proceeding to support this statement. In fact, a review of the evidence in EB-2005-0520 shows the exact opposite. In particular, pages 1 and 4 of Schedule 2, Attachment #2 of the response to Exhibit J14.42 shows that Union has substantially under forecast the total C1 Transportation Service Block (account 179-69) and the Other S&T Services (account 179-73). This interrogatory response is attached in Appendix C of this Argument. In 2004, the actual margin in account 179-69 was $5.638 million compared to a Board Approved forecast level of $0.456 million, a forecast error of more than 1,100 percent! The forecast error for account 179-73 was somewhat smaller, at more than 100%. In both cases the forecast error is substantially larger than that for other revenue streams such as that for in-franchise customers.

It should also be noted that Union did not forecast any net revenues in account 179-74 for 2004. As shown in Exhibit A, Tab 2, Appendix B, Schedule 3, page 2 of 2 from EB-2005-0211 (also attached in Appendix C to this Argument), there is a $869,000 credit to ratepayers in this account for 2004, meaning that the total revenue was nearly $1.2 million as compared to $0 forecast.

This forecast error, which favours Union when it comes to sharing a larger portion of the variance than that of the base forecast, has been evidenced for many years.

Union states in their Argument that ***"there is no reason to treat the revenues derived from transitional transportation related services any differently than other forecasted revenues"***. Based on the history noted above, LPMA and WGSP strongly disagree.

The second rationale for eliminating these deferral accounts is the NGF report. LPMA and WGSPG do not necessarily disagree with the objective of reducing the number of variance and deferral accounts. However, a <u>comprehensive review of **ALL** such accounts</u> should be undertaken as part of the incentive regulation mechanism that is still to be determined. These three accounts should remain in place for 2007 and their applicability for 2008 and beyond should be determined, along with that of all other such accounts, as part of the incentive regulation proceeding. If Union actually believes that their forecast for 2007 is accurate, they would be expecting no balances in these accounts for 2007. Thus, there would be no harm to Union of maintaining these three accounts for one more year until the Board has the opportunity to implement a comprehensive incentive regulatory mechanism that includes a detailed analysis and review of the need for all existing deferral and variance accounts.

LPMA and WGSPG therefore submit that the Board deny this proposal and refer the matter to the incentive regulation mechanism proceeding for implementation in 2008.

<u>ii) Long Term Peak Storage Services</u>

The applicable account in this section is 179-72. Unlike the transactional transportation services accounts discussed above, Union Gas is not proposing to share any of the revenues that are generated from ex-franchise customers and, therefore, there is no need for the deferral account. LPMA & WGSPG agree that if the Board determines that Union should not be sharing any of the associated long term peak storage services revenues (margins) with rate payers, then this account should be discontinued.

Unlike the transactional transportation services account discussed above, Union Gas is not proposing to share any of the forecasted revenues that are generated from ex-franchise customers.

LPMA and WGSPG believe that this is one area where the deferral account around any variance from the base forecast could be eliminated. These revenues are generated from long term contracts and appear to be easier to forecast with some degree of accuracy. In particular, a large component of the revenue forecast for any future year is based on multi-year contracts already in place that determine the amount of storage and the rates to be charged in this future test year. As a result, Union's ability to forecast these revenues has been much more accurate than for the other S&T accounts discussed above. In particular, in 2004 the actual gross margin was less than 10% different from the Board approved (forecast) level (see Attachment #2, Schedule 2, page 3 of 4 in the response to J14.42 in EB-2005-0520, included in Appendix C to this Argument).

In this instance, because of the more accurate forecasting results, LPMA and WGSPG believe it may be more acceptable to eliminate this deferral account. This would be contingent on 100% of the base forecast revenues being used to offset the revenue requirement. Any variances around that forecast (positive or negative) would be managed by the utility for the sole benefit of the shareholder.

Again, however, LPMA and WGSPG believe that it may be more appropriate to defer the elimination of this deferral account, assuming there continues to be revenue sharing based on this activity, to a more comprehensive review of all deferral and variance accounts as part of the incentive mechanism proceeding.

iii) Short Term Storage and Other Balancing Services

The applicable account in this section is 179-70. Unlike the transactional transportation services accounts discussed above, Union Gas is not proposing to share any of the revenues that are generated from the short term storage and other balancing services account and, therefore, there is no need for the deferral account. LPMA & WGSPG agree that if the Board determines that Union should not be sharing any of the associated long term peak storage services revenues (margins) with rate payers, then this account should be discontinued.

Unlike the long term storage revenue (account 179-72) above, Union Gas does not have a good track record forecasting these revenues or margins. This may be the result of the type of revenues that go into this account being short term storage and balancing services. These opportunities may arise on short notice and are often the result of weather or other imbalances that would not be included in a normal forecast. Over the period 1999 to 2003 inclusive, the actual gross margin generated by these activities averaged almost $7.7 million. This was nearly triple the Board approved margin over this period. This can be seen in Attachment #2 to Exhibit J14.36 in EB-2005-0540. More notably, however is the significant under forecast for 2004. As shown in Attachment #2, Schedule 2, page 2 of 4 of the response to J14.42 in EB-2005-0520, included in Appendix C to this Argument, the actual 2004 gross margin was more than $22 million, more than triple the Board approved forecast of $6.8 million. Approximately two-thirds of this variance came from shot term peak storage and the remaining one-third came from off peak storage/balancing/loan services.

For the same reasons provided in section (i) above related to transactional transportation related services, there is no justification for elimination of this account based on forecast accuracy. Similarly there is no justification for elimination of this account for 2007 based on the NGF report. Again, a comprehensive review of all accounts should take place as part of the broader incentive regulation mechanism proceeding.

Further as noted above in Part III – Storage Forbearance, a portion, if not all of the revenue generated by these short term activities, is achieved through the use of assets that will continue to be regulated even if the Board were to accept Union's proposal to forbear from regulating storage for ex-franchise customers.

c) Summary of Recommendations on Deferral Accounts

- All five deferral accounts should remain in place for 2007;
- An exception to this would be for accounts 179-70 and/or 179-72 in the event that the Board determines that revenue (margin) sharing for the underlying activities upon which these two accounts is based was not to continue. In that event the associated deferral account should be eliminated;
- The continuation of the remaining S&T deferral accounts beyond 2007 should be deferred to the incentive regulation proceeding in order that a comprehensive review of all deferral and variance costs (not just those associated with S&T) can be evaluated.

V - Costs

LPMA and WGSPG request that they be awarded 100% of their reasonably incurred costs of participating in this proceeding. By separate letters both dated February 15, 2006, the Board found that both the LPMA and the WGSPG were eligible to apply for an award of costs.

Both parties submit that their participation and intervention was done responsibly and efficiently. LPMA and WGSPG were active participants in the settlement process related to the non-storage issues that revolved around new services and rates for gas-fired generators to ensure that there were no significant impact on other rate classes.

Both parties worked with other participants in the storage component of the proceeding, eliminating the need for attendance at the oral hearing and/or duplicative cross-examination. Transcripts were used to follow the hearing.

LPMA and WGSPG shared a consultant to avoid duplication of effort, including the preparation of a joint argument.

All of which is respectfully submitted this 25th day of August, 2006.

Randall E. Aiken

Randall E. Aiken
Consultant to
London Property Management Association
and
Wholesale Gas Service Purchasers Group

Appendix A

EB-2005-0551

Argument of

The London Property Management Association

And

The Wholesale Gas Service Purchasers Group

UNION GAS LIMITED

Answer to Interrogatory from
London Property Management Association ("LPMA")

Reference: *E2/T1/page 25*

Issue 4.3 - Is the proposal to change the existing capital structure, increasing Union's deemed common equity component from 35% to 40% appropriate? (E1/T1/p2)

Question:
It is stated that Union's risk has increased in part due to increased competition in Union's storage and transmission operations.

What is the impact on risk and the associated common equity ratio required if the distribution assets of Union Gas are looked at separately from the storage and transmission assets?

Response:

Union Gas' storage and transportation assets cannot be looked at separately from its distribution assets in evaluating Union Gas' business risk. An equity investor invests in both the storage and transportation assets and the distribution assets of Union Gas.

However, if Union Gas' storage and transportation assets were separated from its distribution assets, then Dr. Carpenter would conclude that Union Gas' storage and transportation assets are more risky than its distribution assets.

UNION GAS LIMITED

Answer to Interrogatory from
London Property Management Association ("LPMA")

Reference: *E2/T2/page 3*

Issue 4.3 - Is the proposal to change the existing capital structure, increasing Union's deemed common equity component from 35% to 40% appropriate? (E1/T1/p2)

Question:
The evidence states that "primarily as a result of Union's competitive exposure to its transportation and storage business" it is concluded that Union is more risky than the portfolio of gas LDC's used by Dr. Vilbert in his evidence.

In the absence of the competitive exposure to its transportation and storage business, would Union have the same risk level as the portfolio of gas LDC's used by Dr. Vilbert? Please explain.

Response:

It is Dr. Carpenter's opinion that a key factor distinguishing Union from the portfolio of U.S. LDC's employed by Dr. Vilbert is the competitive exposure of Union's transportation and storage business. See his evidence on p. 9 line 22 – p. 10 line 3, and footnote 8 on page 9. See also Table MJV-B1 in Appendix B of Dr. Vilbert's evidence for a comparison of the storage and transportation holdings of the companies in his U.S. LDC sample.

See also Union's response to Exhibit J14.75.

Witness: Ken Horner / Pat Elliott / Paul Carpenter
Question: March 14, 2006
Answer: April 4, 2006
Docket: EB-2005-0520

<u>Appendix B</u>

EB-2005-0551

Argument of

The London Property Management Association

And

The Wholesale Gas Service Purchasers Group

Inventory Revaluation Account (Deferral Account No. 179-109)

This deferral account was established in the RP-2003-0063 proceeding to record changes in the value of gas inventory available for sale to sales service customers resulting from changes in Union's weighted average cost of gas as approved by the Board for establishing rates.

S&T DEFERRAL ACCOUNTS:

As per the Board's RP-1999-0017 Decision, the balances in the following deferral accounts are shared between Union and its customers on a 25:75 basis.

Transportation and Exchange Services (Deferral Account No. 179-69)

This deferral account was established to record differences between actual and forecast net revenue from transportation and exchange services. These services include C1 Interruptible Transportation, Energy Exchanges, M12 Transportation Overrun, M12 and C1 Non-LCU Protected Firm Transportation, M12 Limited Firm Transportation, M12 Interruptible Transportation, and C1 Firm Short Term Transportation.

Balancing Services (Deferral Account No. 179-70)

This deferral account was established to record differences between actual and forecast net revenue from balancing services. These services include Consumers LBA, balancing, off-peak storage, and loans.

Long-term Peak Storage (Deferral Account No. 179-72)

This deferral account was established to record differences between actual and forecast long-term storage market premiums.

Other S&T Services (Deferral Account No. 179-73)

This deferral account was established to record differences between actual and forecast net revenue from other storage and transportation services including off system capacity, name changes/redirects, new product development, and services to Ontario producers.

Other Direct Purchase Services (Deferral Account No. 179-74)

This deferral account was established to record differences between actual and forecast net revenue from the sale of supplemental services to direct purchase customers. These services include supplemental load balancing services provided under the R1, T1, and Rate 30 rate schedules and net revenue earned from the T1 storage inventory demand charge.

<u>Appendix C</u>

EB-2005-0551

Argument of

The London Property Management Association

And

The Wholesale Gas Service Purchasers Group

UNION GAS LIMITED

Answer to Interrogatory from
London Property Management Association ("LPMA")

Reference: *C5/T4*

Issue 2.4 - Is the proposed total 2007 Storage and Transportation (S&T) Revenue Forecast appropriate? (C1/T3)

Question:
Please update Schedules 1 through 3 to reflect actual data for 2005.

Response:

Please refer to Attachment #1, #2 and #3, which update the information previously filed in Exhibit C5, Tab 4, Schedule 1, Exhibit C5, Tab 4, Schedule 2 and Exhibit C5, Tab 4, Schedule 3, respectively.

UNION GAS LIMITED
Revenue from Storage and Transportation of Gas
2005 Actual Year vs. 2004 Actual Year
($000's)

Line No.	Particulars	Actual 2005	Actual 2004	Difference
		(a)	(b)	(c)
	S&T Core Services			
	M12 - Long Term:			
1	M12 Storage	-	1,467	(1,467)
2	Tecumseh Dehydration	776	738	38
3	M12 Transportation	104,297	104,248	49
4	C1 Long TermTransportation	8,615	4,694	3,921
5	M13 - Local Production	808	860	(52)
6	M15		-	-
7	M16	262	244	18
8	C1 Rebate Program	(937)	(938)	0
9	Total Core Services Revenue (Lines 1 through 8)	113,820	111,313	2,507
	S&T Transactional Servi ces			
	C1 Storage Services			
10	Long Term Storage Services	36,580	36,579	1
11	Short Term Storage Services	18,220	14,613	3,608
12	Off Peak Storage/Balancing/Loan Services	4,087	12,981	(8,894)
13	Consumers' LBA	153	335	(182)
14	C1 Short Term Transportation and Exchanges	3,956	6,868	(2,912)
15	M12 Transportation Overrun/Limited Firm	3,465	4,983	(1,518)
16	Other S&T Revenue	1,115	1,089	26
17	Total Transactional Services Revenue (Lines 10 through 16)	67,577	77,448	(9,871)
18	Total S&T Revenue (Line 9 + Line 17)	181,397	188,761	(7,364)

Union Gas Limited
Transportation and Exchange Revenues Account 179-69
For the Years Ending December 31
($000's)

Line No.	Particulars		Actual 2005 (a)	Actual 2004 (b)	Difference (c)
	Transportation and Exchange				
1	Revenue	(1)	3,956	6,868	(2,912)
2	Less: Costs		2,194	1,230	964
3	Gross Margin		1,762	5,638	(3,876)
4	Less: Board Approved		456	456	-
5	Deferred Margin		1,306	5,182	(3,876)
	M12 Transportation Overrun/Limited Firm				
6	Revenue	(2)	3,465	4,983	(1,518)
7	Less: Costs		-	-	-
8	Gross Margin		3,465	4,983	(1,518)
9	Less: Board Approved		232	232	-
10	Deferred Margin		3,233	4,751	(1,518)
	Total C1 Transporation Service Block				
11	Revenue (Line 1+ Line 6)		7,421	11,851	(4,430)
12	Less: Costs (Line 2 + Line 7)		2,194	1,230	964
13	Gross Margin (Line 11 - Line 12)		5,227	10,621	(5,394)
14	Less: Board Approved (Line 4 + Line 9)		688	688	-
15	Deferred Margin (Line 13- Line 14)		4,539	9,933	(5,394)

Notes:
(1) See C1, Summary Schedule 7, Addendum Line 14
(2) See C1, Summary Schedule 7, Addendum Line 15

Union Gas Limited
Short Term Storage and Other Balancing Services Account 179-70
For the Years Ending December 31
($000's)

Line No.	Particulars		Actual 2005	Actual 2004	Difference
			(a)	(b)	(c)
	C1 Short Term Peak Storage				
1	Revenue	(1)	18,220	14,613	3,607
2	Less: Costs		3,978	3,108	870
3	Gross Margin		14,242	11,505	2,737
4	Less: Board Approved		1,765	1,765	-
5	Deferred Margin		12,477	9,740	2,737
	Off Peak Storage/Balancing/Loan Services				
6	Revenue	(2)	4,087	12,981	(8,894)
7	Less: Costs		3,177	2,793	384
8	Gross Margin		910	10,188	(9,278)
9	Less: Board Approved		4,953	4,953	-
10	Deferred Margin		(4,043)	5,235	(9,278)
	Enbridge LBA				
11	Revenue		153	335	(182)
12	Less: Costs	(3)	-	-	-
13	Gross Margin		153	335	(182)
14	Less: Board Approved		75	75	-
15	Deferred Margin		78	260	(182)
	Total Balancing Service Block				
16	Revenue (Line 1 + Line 6 + Line 11)		22,460	27,929	(5,469)
17	Less: Costs (Line 2 + Line 7 + Line 12)		7,155	5,901	1,254
18	Gross Margin (Line 16 - Line 17)		15,305	22,028	(6,723)
19	Less: Board Approved (Line 4 + Line 9 + Line 14)		6,793	6,793	-
20	Deferred Margin (Line 18 - Line 19)		8,512	15,235	(6,723)

Notes:
(1) See C1, Summary Schedule 7, Addendum Line 11
(2) See C1, Summary Schedule 7, Addendum Line 12
(3) See C1, Summary Schedule 7,Addendum Line 13

Union Gas Limited
Long Term Peak Storage Services Account 179-72
For the Years Ending December 31
($000's)

Line No.	Particulars		Actual 2005 (a)	Actual 2004 (b)	Difference (c)
	Market Premium				
1	Long Term Storage Revenue	(1)	36,580	36,579	777
2	Less: Costs		20,129	20,308	597
3	Gross Margin (Line 1 - Line 2)		16,451	16,271	180
4	Less: Board Approved		17,965	17,965	-
5	Long Term Market Premium (Line 3 - Line 4)		(1,514)	(1,694)	180

Notes:
(1) See C1, Summary Schedule 7, Addendum Line 10

Union Gas Limited
Other S&T Services Account 179-73
For the Years Ending December 31
($000's)

Line No.	Particulars		Actual 2005	Actual 2004	Difference
			(a)	(b)	(c)
	Other S&T Services				
1	Revenue	(1)	1,115	1,089	26
2	Less: Costs		87	90	(3)
3	Gross Margin (Line 1 - Line 2)		1,028	999	29
4	Less: Board Approved		460	460	-
5	Deferred Margin (Line 3 - Line 4)		568	539	29

Notes:
(1) See C1, Summary Schedule 7, Addendum Line 16

UNION GAS LIMITED
Storage and Transportation Details
As at November 1, 2005

Line No.	Description	Contracted Capacity at Nov 1	Unit		Revenue
		(a)			(b)
	S&T Core Services				
1	M12 Transport	3,903,498	GJ/d	(1)	104,296
	S&T Transactional Services				
	C1 Storage Services				
2	Long Term	64,286,808	GJ	(2)	36,580
3	Short Term	8,054,494	GJ	(3)	18,220
4	Other Storage Services	-	GJ	(4)	4,087
5		72,341,302			46,056

Notes:
(1) See Exhibit C5 Tab 4 Schedule 1 Addendum Line 3
(2) See Exhibit C5 Tab 4 Schedule 1 Addendum Line 10
(3) See Exhibit C5 Tab 4 Schedule 1 Addendum Line 11
(4) See Exhibit C5 Tab 4 Schedule 1 Addendum Line 12

UNION GAS LIMITED
Deferral Account Balances
Year Ending December 31, 2004
($000's)

Line No.	Account Number	Account Name	Balance *
	Storage and Transportation Accounts:		
13	179-69	Transportation and Exchange Services	(7,449)
14	179-70	Short Term Storage and Balancing Services	(11,774)
15	179-72	Long-term Peak Storage	1,270
16	179-73	Other S&T Services	(405)
17	179-74	Other Direct Purchase Services	(869)
	Other:		
18	179-26	Deferred Customer Rebates/Charges	-
19	179-56	Comprehensive Customer Information Program	-
20	179-60	Direct Purchase Revenue and Payments	834
21	179-75	Lost Revenue Adjustment Mechanism	-
22	179-102	Intra-period WACOG Changes	(674)
23	179-103	Unbundled Services Unauthorized Storage Overrun	-
24	179-110	Storage Rights Compensation Costs	1,383
25	179-111	Demand Side Management Variance Account	618
26	179-112	Gas Distribution Access Rule Costs	-
27	179-113	Late Payment Penalty Litigation	56
28	179-114	Incremental OEB Cost Assessment	2,692
29	Total Non-Gas Accounts (Lines 13 through 28)		(14,318)
30	Total Deferral Account Balances (Lines 12 + 29)		$ (33,909)

* Includes interest to December 31, 2004