



EB-2007-0598

IN THE MATTER OF the *Ontario Energy Board Act*
1998, S.O.1998, c.15, (Schedule B);

AND IN THE MATTER OF an Application by Union
Gas Limited for an order or orders amending or
varying the rate or rates charged to customers as of
July 1, 2007.

BEFORE: Paul Sommerville
Presiding Member

Ken Quesnelle
Member

DECISION AND ORDER

1. Introduction

1.1. The Application

Union Gas Limited ("Union" or the "Company") filed an application on April 27, 2007 with the Ontario Energy Board (the "Board") seeking approval for final disposition and recovery of certain 2006 year-end deferral account balances and the 2006 year-end earnings sharing amount. Union also proposed that the resulting impacts from the disposition be implemented on July 1, 2007 to align with other rate changes expected to result from the Quarterly Rate Adjustment Mechanism ("QRAM") proceeding. Union revised the proposed timing to align with the October QRAM.

1.2. The Proceeding

The Board issued a Notice of Written Hearing and Procedural Order No. 1, dated May 16, 2007, setting the dates for submissions on Union's evidence and other procedural matters. As part of the Order, any parties that objected to proceeding by way of written hearing were required to provide good reason why any issues should proceed by way of an oral hearing.

On May 24, 2007 the Industrial Gas Users Association ("IGUA") requested that a matter concerning the treatment of certain deferred taxes, totaling \$10.524 million, proposed for recovery via the Earnings Sharing Mechanism ("ESM") be considered as part of an oral hearing (the "Deferred Taxes Issue"). The Deferred Taxes Issue is outlined in Account No. 179-72 Long-Term Peak Storage Services, Ex. A, Tab 1 of Union's evidence which states, "Included in the actual cost to provide storage services in 2006 is an increase in deferred income tax expense of \$10.524 million resulting from the Board's decision in the Natural Gas Electricity Interface Review ("NGEIR")."

On June 22, 2007 the Board issued Procedural Order No. 2 involving a confidentiality request, to schedule an oral hearing, and to amend scheduling with regards to this proceeding. The oral hearing with respect to the Deferred Taxes Issue was set for July 9, 2007.¹ All other issues remained part of the written hearing.

On July 6, 2007 Union provided a list of witnesses to all parties and the Board also received a position paper from ratepayer representatives as guidance for the oral hearing. The paper was submitted by IGUA and written on behalf of the London Property Management Association ("LPMA"), the School Energy Coalition ("SEC"), the Vulnerable Energy Consumers Coalition ("VECC"), the Consumers Council of Canada ("CCC"), and IGUA.

On July 9, 2007 the Board held an oral hearing concerning the Deferred Taxes Issue. All other issues in this proceeding were dealt with by way of a written hearing. This decision deals with the matters heard both orally and in writing.

¹ As defined in Procedural Order No. 2

1.3. Structure of this Decision

A brief summary of the deferral accounts and amounts requested for disposition is presented in section 2. This is followed by discussion of the Deferred Taxes Issue and other Earnings Sharing amounts for 2006. A summary of these accounts is attached as Appendix "A". A list of witnesses and participants is attached as Appendix "B".

2. The Deferral Accounts

Union applied for disposition of the deferral accounts as follows:

Gas Supply related (credit)	\$	197.804
Storage and Transportation related (credit)	\$	16.991
Other (debit)	\$	<u>(35.224)</u>
Total (credit)	\$	179.571 million

The individual components are as follows:

Gas Supply related deferral accounts:

The net balance in the 2006 Gas Supply related deferral accounts as of December 31, 2006 was a \$197.804 million credit. The accounts are:

- North Purchased Gas Variance Account (179-105)
- TCPL Tolls and Fuel – Northern and Eastern Operations Area (179-100)
- South Purchased Gas Variance Account (179-106)
- Inventory Revaluation Account (179-109)
- Spot Gas Variance Account (179-107)
- Heating Value Deferral Account (179-89)
- Unabsorbed Demand Cost Deferral Account (179-108)

Storage and Transportation related deferral accounts:

At the end of December 2006, Union stated that the balance accumulated in the Storage and Transportation related deferral accounts was a credit of \$16.991 million (ratepayer portion).

The accounts are:

- Transportation and Exchange Services Deferral Account (179-69)

- Short Term Storage and Other Balancing Services Deferral Account (179-70)
- Long Term Peak Storage Services Deferral Account (179-72)
- Other S&T Services Deferral Account (179-73)
- Other Direct Purchase Services Deferral Account (179-74)

Other deferral accounts

At the end of December 2006, the balance accumulated in the “Other” deferral accounts was a debit of \$35.224 million. The “Other” deferral accounts are:

- Deferred Customer Rebates/Charges Account (179-26)
- Comprehensive Customer Information Program Account (179-56)
- Direct Purchase Revenue and Payments Deferral Account (179-60)
- Lost Revenue Adjustment Mechanism Deferral Account (179-75)
- Intra-period WACOG Deferral Account (179-102)
- Unbundled Services Unauthorized Storage Overrun Account (179-103)
- Storage Rights Compensation Costs Deferral Account (179-110)
- Demand Side Management Variance Account (179-111)
- Deferred Gas Distribution Access Rule Costs (179-112)
- Late Payment Litigation Deferral Account (179-113)
- Incremental OEB Cost Assessment Deferral Account (179-114)
- Shared Savings Mechanism Variance Account (179-115)
- Interest on the Gain on the 2004 Cushion Gas Disposition (179-116)
(subject of proceeding EB-2005-0211)

The Company explained the basis for the balances in each account. Intervenors raised concerns about Union’s treatment of the disposition of the Long-Term Peak Storage Services deferral account. The Company provided its rationale for a significant deferred tax charge to ratepayers based on the Board’s NGEIR Decision (EB-2005-0551).

The Board accepts Union’s evidence regarding the account balances and Union’s proposal regarding the allocation and amounts of the balances and the proposed timing for disposition, with the exception of the Long-Term Peak Storage Services deferral account (Account No. 179-72) (“LSS account”), Lost Revenue Adjustment Mechanism Deferral Account (Account No. 179-75)

("LRAM account"), and the Demand Side Management Variance Account (Account No. 179-111) ("DSMVA account"). The discussion and treatment of these accounts are outlined later in this decision.

3. The Deferred Taxes Issue

Background

The Deferred Taxes Issue involves a claim by Union for certain amounts in the LSS account (Account No. 179-72).

Union claims that it is required to record a deferred income tax expense of \$10.524 million related to storage service as a result of the change in the regulatory treatment of storage services provided to customers outside of Union's franchise area.

Union asserted that the change in accounting treatment results from the Board's decision in NGEIR to refrain from regulating rates for storage services to customers outside Union's franchise area and for new storage services to customers within the franchise area.

Union's contention is that the Canadian Generally Accepted Accounting Principles ("GAAP") require that once a segment of a utility's operation ceases to be rate regulated, as is the case with ex-franchise storage services, that portion of the company's operation ceases to qualify for deferred tax accounting treatment. Accordingly, the deferred tax deferral account which has been in place since 1997 cannot continue to capture amounts related to these operations.

The Oral Hearing

Union Gas Limited

In its oral argument Union asserted that the appropriate time to give effect to the change in accounting treatment arose as soon as the Board's Decision in NGEIR

had been made in November of 2006. Its view was rooted in the understanding that as soon as there is no expectation of regulated revenues to offset the future tax liability, the liability must be recorded as a deferred tax expense in the period when the change in status from regulated to non-regulated occurred.

It is Union's position that insofar as the ex-franchise storage service business can no longer use the "flow through" method of recording the tax liabilities associated with it, the entire amount of the tax liability must be recorded in the current period, and should also be applied to its revenue requirement for the regulated business and reflected in current rates.

Furthermore, Union contended that the use of the "flow through" method up to the point that the Board made its NGEIR Decision operated to the benefit of its customers and that accordingly they should now realize the offsetting debit of those associated liabilities. Union contended that the deferral of taxes for accounting purposes over the period from 1997 to 2006 has had the effect of reducing Union's revenue requirement to the extent that current tax liability was deferred. Union urged that the principle that "burdens follow benefits", should be applied by the Board to recover the accumulated tax liability reflected in the account from ratepayers now.

Position of the Parties

One position paper was submitted by all intervenors representing ratepayer interests that emphasized three points in their opposition to Union's treatment of the Deferred Taxes Issue. That paper considered whether there is:

- (a) any basis for this charge to be reflected in 2006; and
- (b) any basis that the Board could conclude that the recent characterization of Union's ex-franchise storage business as non-utility could give rise to a recovery of amounts recorded in the deferred tax account; and
- (c) any rationale for the recovery of other amounts in the future.

IGUA articulated the opposition of a number of intervenors regarding the appropriateness of the time period for the claim. It argued that the change in accounting should be applied when the storage revenues were taken out of the utility's revenue stream. IGUA pointed out that while the Board's NGEIR Decision was issued on November 7, 2006, the rates reflecting the change in status were not effective until January 1, 2007. IGUA argued that there was no cash expense in 2006 associated with the deferred tax liability in question, and that the liability is an amount that Union is not required to address in full until 2018.

IGUA contended that Union's ex-franchise line of business would, by definition, be a non-utility line of business, and therefore purely a shareholder enterprise, denying Union any rationale for the collection of these amounts from ratepayers.

CCC stated that Union's failure to raise the potential impact of the Deferred Taxes Issue in a timely manner is sufficient reason to invalidate Union's claim. It asserts that Union had an obligation to stipulate the potential effect of the NGEIR Decision on the Deferred Taxes Issue earlier, when the NGEIR panel was considering the impact of deregulation of ex-franchise storage services. It suggests that, had the Board panel considering NGEIR known that such an effect had been argued for, it may have affected that Decision.

SEC suggested that the Ernst and Young letter ("E&Y"), dated April 27, 2007, and relied upon by Union in support of its contention, really provided no opinion on Union's decision to adopt the changes in accounting treatment. SEC argued that E&Y's only comment was to assume that Union's choice of year, 2006, was correct and that the accounting treatment was appropriate.

For its part, LPMA secured an undertaking from Union which confirmed that Union's sale of ancillary services on January 1, 1999 did not trigger a deferred tax liability in the 1998 calendar year. LPMA argued that Union should observe a consistent accounting approach to the two events. Further, LPMA argued that crossover on this deferred tax liability does not commence until 2009, and is only

approximately \$150,000.² By 2010, the amount escalates to \$1.0 million, still far less than the \$10.524 million that Union seeks.

LPMA made further argument that 10% of Union's newly deregulated storage asset is composed of cushion gas. Since cushion gas is a non-depreciable asset, depreciation of this asset will never exceed the capital cost allowance, and the asset will never reverse. By definition, 10% of Union's claim can never have an associated deferred tax liability.

VECC followed the submissions of LPMA by commenting on the time value of money and its effect on the disposition of deferral accounts.

The City of Kitchener adopted the submissions of other intervenors and highlighted that they would face a significant charge as Union's sole T3 customer.

Board Findings

The Board notes that while accounting treatment can be an important consideration in the regulatory treatment of matters, it is not always predictive of the regulatory outcome. The fact that Union may have to change its accounting treatment of the deferred tax account as a result of the NGEIR decision, does not automatically lead to the conclusion that the accounting tax liability associated with it should come into rates now, or at all. In the absence of a near certain revenue stream that matches future costs, a company must book the future liability. Regulated entities have the assurance that prudently incurred costs will be offset by regulated revenues and therefore they need not book the future liability. In these circumstances, this rule has limited relevance for how the change may be reflected from a regulatory point of view.

The respective accounting treatments for regulated and non-regulated entities reflect the distinction of one entity having a predictable revenue stream where as the other does not. Furthermore, the CICA handbook does not consider the

² Crossover: For storage assets, the rate of tax depreciation of an asset exceeds the book depreciation in the early years of the asset. This results in a tax savings. The crossover point is when the book depreciation equals tax depreciation. From this point on there is a tax liability associated with asset.

disposition of the historic costs or who bears them in a regulatory context. This remains the purview of the regulator.

The Board finds 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.

The taxes associated with this line of business, including the deferred taxes residing in the account should form a part of this new undertaking. This is the same treatment afforded to like liabilities associated with the divestiture of the ancillary services, detailed in Undertaking J1.3.

The Board is also concerned that the treatment requested by Union would result in a significant cross-generational subsidy. The deferral account has been in operation since 1997. It is inequitable that today's ratepayers should be burdened with costs that have accumulated over that period.

The Board finds that Union must eliminate any and all deferred income tax expense from the LSS account. The balance in the LSS account shall be revised from of a debit of \$9.341 million to a credit of \$3.015 million to ratepayers.³

4. Earnings Sharing

Union proposed to clear the Demand Side Management Variance Account ("DSMVA") using 2004 allocation factors by rate class. Given the fact that Union has the 2006 actual allocation factors at its disposal, the Board finds that Union must update the DSMVA amounts to reflect 2006 actual allocation factors. This does not affect the balance for disposition.

Intervenors expressed concern that the Lost Revenue Adjustment Mechanism Account ("LRAM") reflects unaudited amounts, and argued that Union should wait until the final 2006 audited statements become available. In the previous disposition of deferral accounts (EB-2006-0057) the Board approved Union's

³ As stated in Interrogatory Response to IGUA, Exhibit B3.3.

2005 unaudited LRAM amounts prior to final audited financial statements. The Board finds it appropriate that the 2006 LRAM forecast be used subject to true-up of the audited amount.

Union proposed a “non-utility adjustment” to corporate earnings to exclude \$1.278 million from earnings subject to sharing. LPMA requested further details on the adjustment through interrogatories. In connection with Rules 10 and 29.02 of the OEB’s Rules of Practice and Procedure, Union requested that any interrogatories be held in confidence by the Board. The Board granted Union’s request.

Respecting the confidential nature of the claim, and the evidence and argument presented, the Board finds that the proposed adjustment is directly attributable to the utility’s regulated business, and would not possibly have been made otherwise. Union shall include \$1.278 million associated with the “other non-utility adjustment” as part of the 2006 Earnings Sharing Calculation (Exhibit A, Tab 1, Schedule 4).

5. Costs

A decision regarding cost awards will be issued at a later date. The eligible parties shall submit their cost claims by August 30, 2007. A copy of the cost claim must be filed with the Board and one copy is to be served on Union. The cost claims must be done in accordance with the Board's Practice Direction on Cost Awards.

Union will have until September 14, 2007 to object to any aspect of the costs claimed. A copy of the objection must be filed with the Board and one copy must be served on the party against whose claim the objection is being made.

The party whose cost claim was objected to, will have until September 21, 2007 to make a reply submission as to why their cost claim should be allowed. Again, a copy of the submission must be filed with the Board and one copy is to be served on Union.

THE BOARD ORDERS THAT:

1. The 2006 actual year end Gas Supply, Storage and Transportation and Other deferral account balances are approved, as listed in Appendix "A" with the exception of the balance in the Long-Term Peak Storage Services Account (Account No. 179-72). The balance in this account shall be revised to a credit of \$3.015 million to ratepayers. Union shall revise Table 3 at Exhibit A, Tab 1, page 11 to agree with Union's interrogatory response at Exhibit B3.3. Union is directed to file this updated table with the Board by way of letter.
2. The balances in the deferral accounts shall be cleared as proposed by way of adjustments to customers' bills timed with the next QRAM cycle October 1st through December 31, 2007.
3. Earnings sharing disposal shall be timed with the next QRAM for M2, Rate 01 and Rate 10 customers and as a one time adjustment for in-franchise contract and ex-franchise rate classes. Earnings sharing interest shall accrue from January 1, 2007 at Union's approved short term borrowing rate. Union is directed to file an updated version of the Earnings Sharing Calculation table (Exhibit A, Tab 1, Schedule 4) to include the "non-utility adjustment" in earnings sharing, as well as any effects attributed to the revised balance of the Long-Term Peak Storage Services Account as set out in this order.
4. Union is directed to re-allocate the 2006 Demand Side Management Variance Account amounts on the basis of actual 2006 allocation factors.

DATED at Toronto, August 17, 2007

ONTARIO ENERGY BOARD

Original signed by

Peter H. O'Dell
Assistant Board Secretary

APPENDIX A

2006 Gas Supply Related Deferral Accounts

Account No	Account Description	
(179-105)	North Purchased Gas Variance Account	\$54.735m credit
(179-100)	TCPL Tolls and Fuel – Northern and Eastern Operations Area	\$0.522m credit
(179-106)	South Purchased Gas Variance Account	\$145.719m credit
(179-109)	Inventory Revaluation Account	(\$12.769m) debit
(179-107)	Spot Gas Variance Account	\$6.484m credit
(179-108)	Unabsorbed Demand Costs	\$0.708m credit
(179-89)	Heating Value Deferral Account	\$2.405m credit

Storage and Transportation Related Deferral Accounts

The storage and transportation related deferral accounts are:

Account No	Account Description	
(179-69)	Transportation and Exchange Services Deferral Account	\$4.004m credit
(179-70)	Short Term Storage and Other Balancing Services Deferral Account	\$21.565m credit
(179-72)	Long Term Peak Storage Services Deferral Account	\$3.015m credit
(179-73)	Other S&T Services Deferral Account	\$0.390m credit
(179-74)	Other Direct Purchase Services Deferral Account	\$0.373m credit

Other Deferral Account

The other deferral accounts are:

Account No	Account Description	
(179-26)	Deferred Customer Rebates/Charges Account	\$0
(179-56)	Comprehensive Customer Information Program Account	\$0
(179-60)	Direct Purchase Revenue and Payments Deferral Account	\$0.171m credit
(179-75)	Lost Revenue Adjustment Mechanism Deferral Account	(\$4.088) debit
(179-102)	Intra-period WACOG Deferral Account	(\$15.742m) debit
(179-103)	Unbundled Services Unauthorized Storage Overrun Account	\$0
(179-110)	Storage Rights Compensation Costs Deferral Account	(\$0.511m) debit
(179-111)	Demand Side Management Variance Account	(\$7.213m) debit
(179-112)	Deferred Gas Distribution Access Rule Costs	Not available
(179-113)	Late Payment Litigation Deferral Account	(\$0.303m) debit
(179-114)	Incremental OEB Cost Assessment Deferral Account	(\$1.541m) debit
(179-115)	Shared Savings Mechanism Variance Account	(\$7.000m) debit
(179-116)	Interest on the Gain on the 2004 Cushion Gas Disposition	\$0.896m credit

APPENDIX B

Participants and Witnesses

List of Participants

Board Counsel	Michael Millar
Board Staff	Vincent Cooney
Union Gas Limited	Michael Penny Michael Packer Chris Ripley Annabelle Anchetta
City of Kitchener	Jim Gruenbauer
Consumers Council of Canada	Robert Warren
Enbridge Gas Distribution	Barbara Bodnar
Industrial Gas Users Association	Peter Thompson
London Property Management Association	Randy Aiken
School Energy Coalition	John DeVellis
Vulnerable Energy Consumers Coalition	James Wightman

Witnesses

Union Gas Limited	Patricia Elliott
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