

**ONTARIO ENERGY BOARD**

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

**AND IN THE MATTER OF** an Application by Union Gas Limited for an order or orders amending or varying the rate or rates charged to customers as of July 1, 2009 in connection with the sharing of 2008 earnings under the incentive rate mechanism approved by the Ontario Energy Board on January 17, 2008

**SETTLEMENT AGREEMENT**

**June 4, 2009**

This Settlement Agreement (“Agreement”) is for the consideration of the Ontario Energy Board (“the Board”) in its determination, under Docket No. EB-2009-0101, of the disposition of Calendar 2008 earnings sharing under a settlement agreement approved by the Board on January 17, 2008 in EB-2007-0606 (the “IR Settlement Agreement”) for Union Gas Limited (“Union”). By Procedural Order No.1 dated April 28, 2009, the Board scheduled a Settlement Conference to commence May 27, 2009. The Settlement Conference was duly convened, in accordance with Procedural Order No. 1, with Mr. George Dominy as facilitator. The Settlement Conference proceeded until May 28, 2009.

The settlement presented in this Agreement is comprehensive in that the agreement that has been reached settles all issues in this proceeding.

The Agreement is supported by the evidence filed in the EB-2009-0101 proceeding.

The purpose of this proceeding was:

- (a) to provide Union’s calculation of its 2008 utility earnings for the purposes of earnings sharing pursuant to Section 10.1 of the IR Settlement Agreement. Section 10.1 of the IR Settlement Agreement provides:

*“If in any calendar year Union’s actual utility return on equity is more than 200 basis points over the amount calculated annually by the application of the Board’s ROE formula in any year of the IR plan, then such excess earnings will be shared 50/50 between Union and its customers. For the purposes of the earnings sharing mechanism, Union shall calculate its earnings using the regulatory rules prescribed by the Board from time to time, and shall not make any material changes in accounting practices that have the effect of reducing utility earnings. All revenues that would be included in revenues in a cost of service application shall be included in the earnings calculation and only those expenses (whether operating or capital) that would be allowable as deductions from earnings in a cost of service application shall be included in the earnings calculation.*

*Parties acknowledge that the DSM related Shared Savings Mechanism (SSM) and Lost Revenue Adjustment Mechanism (LRAM) and storage related deferral accounts are outside of the earnings sharing mechanism identified above.”*

- (b) to consider Union's application pursuant to section 9.1 of the IR Settlement Agreement.

Section 9.1 provides:

*"The parties agree that if there is a 300 basis point or greater variance in weather normalized utility earnings above or below the amount calculated annually by the application of the Board's ROE formula in any year of the IR plan, Union will file an application to the Board, with appropriate supporting evidence, for a review of the price cap mechanism. During the course of that review, the Board may be asked to determine whether it is appropriate to continue the price cap mechanism for future years and, if so, with or without modifications. All parties including Union will be free to take such positions as they consider appropriate with respect to that application, including without limitation; a) proposing that a component of the IR Plan, including the X factor, be adjusted, b) proposing that IR plan be terminated, and c) taking any other positions as the party may consider relevant and the Board agrees to hear. Union shall file such application as soon as reasonably possible in the year following the year in which the over earnings threshold is met, unless all parties to this Agreement agree otherwise at that time."*

It is acknowledged and agreed that none of the provisions of this Agreement is severable. If the Board does not, prior to the commencement of the hearing of the evidence in EB-2009-0101, accept the Agreement in its entirety, there is no Agreement (unless the parties to the Agreement agree that any portion of the Agreement the Board does accept may continue as a valid agreement).

It is further acknowledged and agreed that parties to the Agreement will not withdraw from this Agreement under any circumstances except as provided under Rule 32.05 of the Board's Rules of Practice and Procedure.

The participants in the Settlement Conference agree that all positions, negotiations and discussion of any kind whatsoever which took place during the Settlement Conference and all documents exchanged during the conference which were prepared to facilitate settlement discussions are strictly confidential and without prejudice, and inadmissible unless relevant to the resolution of any ambiguity that subsequently arises with respect to the interpretation of any provision of this Agreement.

The role adopted by Board Staff in Settlement Conferences is set out on page 5 of the Board's Settlement Conference Guidelines. Although Board Staff is not a party to this Agreement, as noted in the Guidelines, "Board Staff who participate in the settlement conference are bound by the same confidentiality standards that apply to parties to the proceeding".

The evidence supporting the Agreement is set out in the Agreement. Abbreviations will be used when identifying exhibit references. For example, Exhibit B1, Tab 4, Schedule 1, Page 1 will be referred to as B1/T4/S1/p1. There are Appendices to the Agreement which provide further evidentiary support. The structure and presentation of the settled issues is consistent with settlement agreements which have been accepted by the Board in prior cases. The parties agree that this Agreement and the Appendices form part of the record in the proceeding.

In Procedural Order No. 1 in this proceeding, the Board granted intervenor status to all intervenors of record in EB-2007-0606 and EB-2008-0220. The following entities participated in the Settlement Conference:

Building Owners and Managers Association of the Greater Toronto Area ("BOMA")  
Canadian Manufacturers & Exporters ("CME")  
Consumers Council of Canada ("CCC")  
Industrial Gas Users Association ("IGUA")  
City of Kitchener ("Kitchener")  
London Property Management Association ("LPMA")  
School Energy Coalition ("SEC")  
The City of Timmins ("Timmins")  
Union Gas Limited ("Union")  
Vulnerable Energy Consumers Coalition ("VECC")  
Wholesale Gas Services Purchasers Group ("WGSPG")  
Energy Probe ("EP")  
Federation of Rental-housing Providers of Ontario ("FRPO")

The parties to this Agreement include all of the above noted entities except IGUA (the “parties”). The parties to this Agreement represent major stakeholders and constituencies with an interest in Union’s rates.

The parties to this settlement encourage the Board to accept this Agreement in its entirety. The parties to this Agreement also support finalization of the rate order in these proceedings to enable implementation of this Agreement in Union’s July 1 QRAM.

## **1. Earnings Sharing Calculation and Off Ramp Amendments**

(Complete Settlement)

The parties agree that, upon approval of this Agreement by the Board, the IR Settlement Agreement shall, for the entire IR term, 2008 to 2012, be amended as follows (for the assistance of parties and the Board, the agreed upon amendments to the IR Settlement Agreement are blacklined below):

9.1 [Section 9.1 of the IR Settlement Agreement shall be deleted in its entirety.]

10.1 The parties agree that there will be an earnings sharing mechanism, based on actual utility earnings. If in any calendar year Union’s actual utility return on equity is more than 200 basis points but not more than 300 basis points over the amount calculated annually by the application of the Board’s ROE formula in any year of the IR plan, then such excess earnings will be shared 50/50 between Union and its customers. In addition to the above, if in any calendar year Union’s actual utility return on equity is more than 300 basis points over the amount calculated annually by the application of the Board’s ROE formula in any year of the IR plan, then such earnings in excess of 300 basis points will be shared 90/10 between customers and Union (i.e., customers will be credited 90% and Union will be credited 10%). For the purposes of the earnings sharing mechanism, Union shall calculate its earnings using the regulatory rules prescribed by the Board from time to time, and shall not make any material

changes in accounting practices that have the effect of reducing utility earnings. All revenues that would be included in revenues in a cost of service application shall be included in the earnings calculation and only those expenses (whether operating or capital) that would be allowable as deductions from earnings in a cost of service application shall be included in the earnings calculation. For greater clarity, Union's one time accounting adjustment in 2008 to true up an unbilled revenue accrual to reflect Union's current rate structure and billing cycles, in the amount of \$3.6 million, is an adjustment that is excluded from the calculation of actual utility earnings, whereas the use of actual unaccounted for gas volume is an expense that would be recorded in the calculation of actual utility earnings.

The parties believe that these amendments to the Board-approved IR Settlement Agreement are in the public interest. The amendments are intended to modify the IR formula so as to in produce rates which are just and reasonable during the IR term. The Agreement:

1. clarifies possible ambiguities in the calculation of earning sharing in section 10.1 of the IR Settlement Agreement arising from the relationship between the use of actual utility earnings and the *proviso* in section 10.1 restricting any adjustments in the calculation of actual utility earnings to those adjustments to actual earnings that would be made in a cost of service filing. Intervenors took the position, for example, that none of the adjustments proposed by Union in the calculation of 2008 actual utility earnings were appropriate. Union took the position that all of its proposed adjustments were in accordance with the IR Settlement Agreement. This Agreement avoids the cost and uncertainty of litigation over these disputes, now and in the future, by resolving which adjustments to the calculation of actual utility earnings, for the purposes of earnings sharing, are appropriate;
2. provides additional potential benefits to customers during the term of the IR plan, 2008 to 2012, in circumstances where Union's actual utility income exceeds the amount

calculated by the application of the Board's ROE formula in any year of the IR plan by over 300 basis points, by crediting 90% of such earnings to customers.<sup>1</sup> The consumer protection afforded by the "off ramp" provision for review in section 9.1 of the IR Settlement Agreement has been replaced with crediting 90% of earnings over the 300 basis point threshold to customers, i.e., Union will have a modest incentive to pursue even greater productivity initiatives and customer bills will go down, all else equal, to the extent Union delivers earnings in excess of the 300 basis point threshold. The parties acknowledge that the elimination of the "off ramp" review in section 9.1 is without prejudice to all rights afforded under section 6.1 (Z Factors) of the IR Settlement Agreement;

3. provides greater certainty and incentive for Union to explore and make investments in productivity improvements during the term of the 2008 to 2012 IR plan;
4. continues to provide for annual reviews during the term of the IR plan during which intervenors will be able to carefully review the reasons and calculation of sharing for all earnings in excess of 200 basis points over the amount calculated annually by the application of the Board's ROE formula in any year of the IR plan.
5. avoids complex, lengthy and highly controversial and contested disputes over the potential for termination of the IR plan and the need for a new full cost of service proceeding. In this case, intervenors took the position, for example, that the proper calculation of weather normalized utility earnings in 2008 was materially in excess of the 300 basis point threshold which gave intervenors the right to seek a review of the IR plan, the consideration of adjustments to the components of the IR plan, including base rates, and the termination of the IR plan and a return to cost of service rates, just as Union would have had the right to take the same position had the company under-earned by an equivalent amount. Union took the position that the IR plan was working as contemplated and producing significant benefits for customers and that the termination of

---

<sup>1</sup> Union does not currently forecast exceeding the 300 basis point threshold in 2009 or 2010.

incentive regulation after the first year of the five year plan was premature and inappropriate. Union will be applying in 2012 for 2013 cost of service rebasing in any event; and

6. avoids complex, lengthy and highly controversial and contested disputes over 2007 base rates and the potential for further adjustments to those base rates during the IR plan. For example, intervenors took the position that Union's 2007 normalized utility earnings were materially higher than the forecast available during the period in which the IR Settlement Agreement was negotiated and that adjustments to the IR plan, such as altering the size of the earnings sharing deadband, altering the level of earnings sharing, and adjustments to 2008 earnings sharing and/or to base rates during the IR term could be made to take account of this positive variance. Union took the position that such variances were not relevant to 2008 earnings sharing and that no adjustments to the IR plan or to base rates during the IR term, except those, such as Z factors, expressly contemplated by the IR Settlement Agreement, should be made. This issue involved a number of potentially controversial disputes, including disputes over the appropriate calculation methodology, the extent to which the likelihood of favourable variances, and the extent of those variances, was, or ought to have been, known to all parties when the IR Settlement Agreement was negotiated and whether base rate adjustments of this kind are appropriate during the IR term.

The financial consequences of this Agreement for the calculation of 2008 earnings sharing under the IR Settlement Agreement are set out in Appendix A attached to this Agreement. The adjustments in the Agreement to Union's original proposal are the result of compromise by the agreeing parties of their respective positions on the matters listed above. In all of the circumstances, the parties have agreed to increase the customer share of Union's 2008 earnings from the proposed \$15.2 million to \$34.2 million, as outlined in Appendix A.

Consistent with past practice, the customer portion of the amount calculated in Appendix A shall be allocated to rate classes in proportion to Board approved return on equity as set out in the allocation schedule in Appendix B attached to this Agreement. Of the \$34.2 million customer



share of earnings for 2008, approximately \$19.6 million will be allocated to small volume general service customers and approximately \$3.2 million will be allocated to large volume general service customers. Approximately \$4.7 million will be allocated to the large volume contract customers and approximately \$6.7 million to M12 shippers such as Enbridge Gas Distribution Inc. ("EGD"), Gaz Métropolitain inc. ("GMi"), and TransCanada PipeLines Limited ("TCPL"). Approving the settlement reflected in the Agreement, therefore, will benefit all customers but, in particular, will provide benefits to small volume general service customers.

Evidence References:

1. A/p.9-20, A/p.27-29, A/App. B/S.1, A/App. B/S.2, A/App. B/S.3, A/App. D/S.1, A/App. D/S.2
2. Technical Conference, pp. 19-28, 33-34
3. B/T1/S6, B/T2/S1, B/T2/S3, B/T4/S7, B/T4/S8, B/T5/S3
4. J1.1

UNION GAS LIMITED  
Earnings Sharing Calculation  
Year Ended December 31, 2008

Line No.	Particulars (\$000's)	2008 (a)	Non-Utility Storage (b)	Adjustments (c)	2008 Utility (d)=(a)-(b)+(c)
Operating Revenues:					
1	Operating revenue	\$ 1,869,283	\$ -	\$ (3,654) i	1,865,629
2	Storage & Transportation	243,317	78,230	-	165,087
3	Other	33,818	-	(7,530) ii	26,288
4		<u>2,146,418</u>	<u>78,230</u>	<u>(11,184)</u>	<u>2,057,004</u>
Operating Expenses:					
5	Cost of gas	1,171,320	8,082	-	1,163,238
6	Operating and maintenance expenses	335,115	12,028	(516) iii	322,571
7	Depreciation	185,219	4,966	-	180,253
8	Other financing	-	-	535 iv	535
9	Property and capital taxes	65,895	953	-	64,942
10		<u>1,757,549</u>	<u>26,029</u>	<u>19</u>	<u>1,731,539</u>
11	Earning Before Interest and Taxes	\$ <u>388,869</u>	\$ <u>52,201</u>	\$ <u>(11,203)</u>	\$ <u>325,465</u>
Financial Expenses:					
12	Long-term debt				143,546
13	Unfunded short-term debt				2,805
14					<u>146,351</u>
15	Utility income before income taxes				179,114
16	Income taxes				31,300
17	Preferred dividend requirements				<u>5,088</u>
18	Utility earnings				<u>142,726</u>
19	Long term storage premium subsidy (after tax)				10,676
20	Short term storage premium subsidy (after tax)				<u>7,484</u>
21					<u>18,160</u>
22	Earnings subject to sharing				\$ <u>160,886</u>
23	Common equity				1,205,196
24	Return on equity (line 22 / line 23)				13.35%
25	Benchmark return on equity				10.81%
26	50% Earnings sharing %				1.00%
27	90% Earnings sharing to ratepayer % (line 24 - line 25 - line 26)				1.54%
28	50% Earnings sharing \$ (line 26 x line 23 x 50%)				6,026
29	90% Earnings sharing to ratepayer \$ (line 27 x line 23 x 90%)				<u>16,697</u>
30	Total earnings sharing \$ (line 28 + line 29)				<u>22,723</u>
31	Pre-tax earnings sharing (line 30 / (1 minus tax rate))				\$ <u>34,170</u>

Notes:

i) Accounting adjustment

ii) Shared Savings Mechanism

iii) Donations	(394)
EB-2008-0304 costs	(122)
	<u>(516)</u>

iv) Customer deposit interest

UNION GAS LIMITED  
Allocation of 2008 Earning Sharing to Rate Classes

Line No.	Particulars	Rate Class	C2007 Return on Equity Allocation (1) (\$000's) (a)	2008 Earning Sharing (\$000's) (b)
<u>Northern &amp; Eastern Operations Area</u>				
1	Small Volume General Firm Service	01	44,549	(5,867)
2	Large Volume General Firm Service	10	8,234	(1,084)
3	Medium Volume Firm Service	20	4,263	(561)
4	Large Volume High Load Factor Firm Service	100	5,641	(743)
5	Large Volume Interruptible Service	25	1,913	(252)
6	Wholesale Transportation Service	77	8	(1)
7	Total Northern & Eastern Operations Area		<u>64,608</u>	<u>(8,509)</u>
<u>Southern Operations Area</u>				
8	Small Volume General Service Rate	M1	104,130	(13,715)
9	Large Volume General Service Rate	M2	15,828	(2,085)
10	Firm Industrial and Commercial Contract Rate	M4	4,220	(556)
11	Interruptible Industrial & Commercial Contract Rate	M5A	2,587	(341)
12	Special Large Volume Industrial & Commercial Contract Rate	M7	2,617	(345)
13	Large Wholesale Service Rate	M9	219	(29)
14	Small Wholesale Service Rate	M10	10	(1)
15	S & T Rates for Contract Carriage Customers	T1	12,835	(1,691)
16	S & T Rates for Contract Carriage Customers	T3	1,546	(204)
<u>Storage and Transportation</u>				
17	Cross Franchise Transportation Rates	C1	186	(24)
18	Storage & Transportation Rates	M12	50,557	(6,659)
19	Transportation of Locally Produced Gas	M13	39	(5)
20	Storage & Transportation Services - Transportation Charges	M16	55	(7)
21	Total Southern Operations Area		<u>194,830</u>	<u>(25,661)</u>
22	Total		<u>259,438</u>	<u>(34,170)</u> (2)

Notes:

(1) Allocated costs per 2007 Decision in EB-2005-0520

(2) Earning Sharing balance for Disposition as per EB-2009-0101, Settlement Agreement, Appendix A