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September 6, 2007

Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street
27th floor
Toronto, ON M4P 1E4

Dear Ms Walli

Union Gas Limited
Application for 2006 Deferral Account and Earnings Sharing Disposition
Board File No.: EB-2007-0598
Our File No.: 302701-000416

In accordance with Procedural Order No. 4 issued on September 4, 2007, we are writing on behalf of our client, the Industrial Gas Users Association ("IGUA"), to object to certain portions of the Draft Order circulated by Union Gas Limited ("Union") on August 27, 2007.

IGUA submits that Union has incorrectly calculated the 2006 Earnings Sharing amount in paragraph 3 of the Draft Order and in Appendix C thereof as a $5.836M credit, including interest up to September 30, 2007.

IGUA submits that, on the basis of the Board's findings in its Decision and Order dated August 17, 2007, the Earnings Sharing amount calculation in Appendix C is a credit amount of about $14.326M rather than the $5.836M credit amount calculated by Union.

The rationale for these submissions is as follows:

(a) In its EB-2007-0598 Decision and Order dated August 17, 2007 (the "Decision"), the Board clearly classified as "non-utility" and non-recoverable from ratepayers the 2006 Deferred Tax liability associated with the notional divestiture of a portion of Union's storage assets supporting the ex-franchise sales of storage services. At page 9 of the Decision, the Board found as follows:

> "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 part of this new undertaking."

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(b) IGUA submits that these findings constitute an equivocal rejection of Union's characterization of the 2006 Deferred Tax liability triggered by the NGEIR Decision as a utility-related transaction.

(c) At transcript page 40, lines 11 to 19 inclusive, Union's witness, Ms Elliott, accepted that "non-utility" items should be excluded from the Earnings Sharing calculation. This was the rationale Union used in an attempt to exclude $1.278M of revenue from the Earnings Sharing calculation.

(d) At transcript page 40, lines 20 to 28 inclusive, Union's witness contended that including Deferred Tax liability revenue adjustments in the Earnings Sharing calculation was appropriate (in the event that the Board disallowed Union's attempt to charge ratepayers for the Deferred Tax liability as a reduction to revenues in the Long Term Storage Revenue Deferral Account) because the liability was a utility-related item. The findings cited above reject Union's contention that the Deferred Tax liability could be treated as a utility transaction for any purpose.

(e) In its Answers to IGUA's Interrogatories in Exhibit B3.4, Union made Deferred Tax liability adjustments to the revenues used in the Earnings Sharing calculation in the event that its proposal to charge the liability to the Long Term Storage Premium Revenue Deferral Account was rejected. Union's response to this Interrogatory prompted a further Interrogatory from IGUA (Exhibit B3.19). In its response to that Interrogatory, Union acknowledged that the Earnings Sharing amount, which it had calculated at $12.879M, would not be subject to Deferred Tax liability adjustments to revenues if the Board decided to treat the Deferred Tax liability as a non-utility elimination.

(f) When cross-examined on these Interrogatory Responses at transcript page 16, line 22 to transcript page 17, line 10, and at transcript page 17, line 15 to transcript page 18, line 7, Union's witness, Ms Elliott, acknowledged that if Union was wrong in the position it was taking with respect to the utility character of the Deferred Tax liability, then, subject to check, the Earnings Sharing amount would be about $14.462M, an amount counsel for IGUA had derived by reversing the $1.278M reduction shown at line 6 of Exhibit A, Tab 1, Schedule 4 and re-doing the math to derive the correct Earnings Sharing amount.

(g) Exhibit C of Union's Draft Rate Order is substantively the same as Union's Response to IGUA Interrogatory Exhibit B3.4, Schedule B. It includes Deferred Tax liability adjustments to revenues at lines 1 and 4. IGUA submits that these adjustments are incorrect for all of the reasons we have outlined.

(h) The Board's Decision with Reasons dated November 24, 2004, in RP-2003-0203 and EB-2004-0468 (copy attached), rejecting an attempt by Enbridge Gas Distribution Inc. ("EGD") to charge an account receivable write-down determined by the Board to be non-recoverable from ratepayers against earnings to be shared with ratepayers, supports the conclusion that Union's Deferred Tax liability adjustments to revenues in its Earnings Sharing calculation should be rejected.

(i) The Board's recent Hydro One EB-2006-0501 Decision with Reasons dated August 16, 2007, also supports the conclusion that Union's Deferred Tax liability

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revenue adjustments should be rejected. At page 81 of the Decision, the Board concluded that the EGD Decision cited in subparagraph (h) of this letter

> "… concerned the write-off of a regulatory balance … determined to be uncollectible from ratepayers, so that it would make little sense to require ratepayers to absorb some of that amount through an ESM.".

Yet, this is precisely what Union has done in its Draft Rate Order. The Draft Rate Order must be corrected.

If we have done the math correctly, then eliminating the Deferred Tax liability adjustments at lines 1 and 4 of Appendix C increases the Earnings subject to sharing at line 9 to $119.213M. We calculate that this amount produces a pre-tax Earnings Sharing amount at line 15 of about $13.849M, and an interest charge amount at line 16 of about $639,000; for a total pre-tax Earnings Sharing credit amount at line 17 of $14.326M, rather than the $5.836M amount calculated by Union.

In making these calculations, we have assumed the income tax rate of 36.12% shown in footnotes 4 and 5 of Appendix C at page 2. This produces a denominator of 0.6388 for the pre-tax earnings calculation at line 15 of Appendix C.

The $14.326M Earnings Sharing amount replaces Union's calculated amount of $5.836M at line 25 of Appendix C, page 1 and the amount at line 26 thereof needs to be adjusted accordingly. Use of the correct Earnings Sharing calculation of about $14.326M in Schedule 1 of the Rate Order Working Papers, as well as in Schedules 2, 3 and 4 thereof, will lead to adjustments to Appendices A, B, D and E of Union's Draft Rate Order.

IGUA urges the Board to direct Union to revise its Draft Rate Order to eliminate the Deferred Tax liability adjustments it has made to the Earnings Sharing amount and to make all consequential revisions to paragraph 3 of the Draft Rate Order and Appendices A, B, C, D and E thereof.

IGUA asks that it be awarded its costs of reviewing Union's Draft Rate Order and preparing these submissions in response thereto.

Please contact me if the Board requires any further information in connection with these submissions.

Yours very truly

Peter C.P. Thompson, Q.C.
PCT\slc
enclosure
c. Interested Parties EB-2007-0598
Murray Newton (Industrial Gas Users Association)
Vince DeRose (Borden Ladner Gervais LLP)
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Ontario Energy Board

Commission de l'Énergie de l'Ontario

Ontario

RP-2003-0203

EB-2004-0468

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

AND IN THE MATTER OF an Application under section 36 of the Act by Enbridge Gas Distribution Inc. for confirmation of the methodology proposed to be used in calculating the earnings sharing mechanism set out in the Fiscal 2004 RP-2003-0048 Decision and Order;

AND IN THE MATTER OF an Application by Enbridge Gas Distribution Inc. for an Order or Orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas commencing October 1, 2004.

BEFORE:

Bob Betts
Presiding Member

Paul Sommerville
Member

Pamela Nowina
Member

George Dominy
Member

DECISION WITH REASONS

Enbridge Gas Distribution Inc. ("EGDI") filed a letter with the Ontario Energy Board (the "Board"), dated September 30, 2004, requesting confirmation of the methodology to be used to calculate the earnings sharing mechanism set out in the Board's decisions and orders in the 2004 Test Year RP-2003-0048 proceeding. 11

The Board assigned file number RP-2003-0203/EB-2004-0468 to the Application. On October 20, 2004, the Board issued a Notice of Written Hearing and Procedural Order No. 1 which ordered that: 12

- Any parties who object to the approach to proceed by way of written hearing shall provide their objections in writing by Wednesday, October 27, 2004; 13

- Parties who wish to make submissions shall do so in writing by no later than Friday, October 29, 2004; 14

- EGDI may reply to the intervenor submissions in writing by no later than Friday, November 5, 2004. 15

The Board received submissions from the Industrial Gas Users Association ("IGUA"), the Vulnerable Energy Consumers Coalition ("VECC"), the School Energy Coalition ("SEC") and the Consumers Counsel of Canada ("CCC") and a reply submission from EGDI. 16

VECC commented on the written procedure established by the Notice of Written Hearing and Procedural Order No. 1. The Board notes that in requesting a further discovery process VECC did not object to a written hearing. The Board is satisfied that the evidence on record and the written submissions that have been filed are sufficient for the Board to render a decision on the matters before it. The Board is not persuaded that any additional evidence obtained through further submissions or an oral hearing would likely be of significant probative value. 17

EGDI has asked the Board for direction specifically related to two earnings sharing mechanism components that have an impact on utility 2004 earnings determinations. 18

1. The Allowed Return on Equity ("ROE") percentage 19

2. The treatment of the charge against earnings of the known non-recoverable portion of the utility deferred tax regulatory receivable 20

1. Allowed Return on Equity ("ROE") Percentage 21

The Board-approved 2004 Test Year rates were set through the application of an indexing mechanism rather than through a full cost of service review. To address concerns for potential over-earnings, the Board imposed a revenue sharing mechanism. 22

23 There is a difference of opinion between EGDI and some other parties as to what the appropriate ROE should be, and this was articulated in correspondence from EGDI, SEC, IGUA and CCC, dated January 22, 2004, February 5, 2004, February 5, 2004 and February 10, 2004 respectively. The respective positions were confirmed in the submissions filed in this proceeding.

24 EGDI's understanding is that the appropriate ROE to use is 9.69% since it was the ROE used in the 2003 rate calculations, and that the 2004 rates were to be indexed relative to those approved 2003 rates. Furthermore, the 9.69% ROE is the last Board-approved ROE for consideration in 2004 rate calculations.

25 SEC, IGUA, CCC and VECC hold that the appropriate ROE to use to determine expected EGDI earnings in 2004 is 9.41%, since this would be the ROE for 2004 if it had been calculated using the Board's *Draft Guidelines on a Formula-Based Return on Common Equity.*

26 The impact of the two views on any 2004 savings to be shared with ratepayers is about $2.5 million, as calculated in the updated Illustration of Alternative Treatments table, reflecting 6 months actual and 6 months forecast, submitted by EGDI on October 19, 2004 and which had been previously filed as an exhibit in the 2005 Test Year proceeding.

27 In the Board's view, a key consideration in confirming the appropriate ROE percentage is that it be consistent with what the Board intended in its 2004 Test Year decision.

28 In the 2004 Test Year oral decision dated September 4, 2003, the Board accepted the partial settlement that provided that rates for 2004 were to be set by applying an indexing mechanism to 2003 Test Year rates rather than through a full cost of service review. To alleviate the concerns that the Board had expressed about potential over-earnings in 2004, the Board had also accepted the Consumer Association of Canada's suggestion that an earnings sharing mechanism be added to the 2004 rate year as a way of providing ratepayer protection.

29 There were two subsequent decisions that potentially could have had an impact on the earnings sharing mechanism particulars:

30 • The Board's RP-2003-0048 Decision and Order, dated October 10, 2003, which varied its oral decision;

31 • The Board's RP-2002-0158/EB-2002-0484 Decision, dated January 16, 2004, in the *Matter of Applications by Union Gas Limited and EGDI for a Review of The Board's Guidelines for Establishing Their Respective Return On Equity.*

32 In these decisions the Board did not order or direct or elaborate on the topic of the 2004 Test Year Allowed ROE.

33 In considering this matter, the Board notes that there were no provisions in any of the three decisions which allowed for the selective adjustment of the cost of service components of the 2003 rates for subsequent indexing to establish 2004 rates. The indexing mechanism was to be applied to the then existing rates for 2003; the cost of service components generating the 2003 rates were unaffected by the mechanism. For the 2003 Test Year, the Board-approved ROE underpinning the 2003 rates was 9.69%. There is no indication that the Board intended to include any changes to this ROE quantum as part of the earnings sharing calculation.

34 Based upon the intent of the 2004 decision and the Board's view that the use of the 9.69% ROE does not lead to an unjust or unreasonable rate outcome for 2004 rates, the Board finds that an ROE of 9.69% shall be used in calculating the level of earnings for EGDI in 2004 for the purposes of determining earnings sharing with ratepayers.

35 **2. Treatment of the Non-Recoverable Receivable Charge**

36 EGDI has asked the Board to confirm the treatment of the non-recoverable receivable in the 2004 earnings sharing determinations. EGDI noted in its letter that in the 2005 Test Year proceeding, intervenors had asked EGDI to re-file its illustration of 2004 utility earnings results to include the alternative treatment of excluding the $26 million non-recoverable receivable as a charge to income and utility normalized earnings in fiscal 2004.

37 EGDI described the non-recoverable receivable of $26 million as the difference between the amount of $50 million initially booked by EGDI in a Notional Utility Account and $23.9 million which reflects the Board's decision to allow the recovery in rates of the amount in deferred taxes that became payable in the October 1, 1999 to May 7, 2002 period. EGDI indicated that accounting standards and guidelines require the charging of the non-recoverable receivable in 2004 thereby impacting the level of earnings that may be available for sharing with ratepayers.

38 The submissions filed by SEC, CCC, IGUA and VECC took issue with the treatment that recognizes the $26 million non-recoverable receivable as a charge to utility fiscal 2004 earnings. The submissions placed particular emphasis on the need, in the earnings sharing calculation, to differentiate between earnings for regulatory purposes and those for financial accounting and reporting purposes.

39 The Board must determine whether the $26 million non-recoverable receivable may be fairly and reasonably used to reduce the earnings in 2004 in calculating the share of earnings attributable to ratepayers in that year.

40 EGDI's decision to write-off the $26 million as a non-recoverable receivable based upon the Board's prior decisions is a clear indication that it was not recoverable from rates, either now or in the past.

41 The coincidental accounting treatment of this write-off in 2004 should not now reduce the ratepayers' share of earnings in the year of the write-off. Earnings determinations should be unfettered by differing accounting treatments and related reporting inclusions and exclusions.

42 For these reasons, the Board finds that the $26 million non-recoverable receivable should not be included as a charge in the 2004 earnings sharing calculation.

43 The Board wishes to make clear that the findings in this Decision do not include a final determination of the ratepayers' share of any 2004 over earnings, which the Board hopes will be settled in an expeditious and cost effective process.

44 The Board is hopeful that any earnings sharing adjustments could be incorporated in the anticipated rate orders to take effect January 1, 2005.

45 Parties claiming costs for this proceeding shall submit their claims at the same time as the claims are to be submitted for the anticipated January 1, 2005 rate order and QRAM proceedings, if applicable.

46 **DATED** at Toronto, November 24, 2004

ONTARIO ENERGY BOARD

Original Signed by Bob Betts

On behalf of the Panel
Bob Betts
Presiding Member