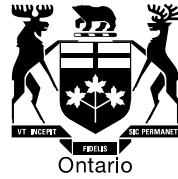


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**BY E-MAIL**

January 24, 2012

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

Dear Ms. Walli:

**Re: Board Staff Submission  
Union Gas Limited – 2012 Rates Application  
Board File No. EB-2011-0025**

Please find attached the Board staff submission with respect to the above noted proceeding.

Yours truly,

*Original signed by*

Lawrie Gluck  
Case Manager

Attachments

C: Chris Ripley (Union)  
Crawford Smith (Torys LLP)  
All Intervenors of Record



# **ONTARIO ENERGY BOARD**

## **BOARD STAFF SUBMISSION**

**Union Gas Limited**

**2012 Rates Application**

**Board File No. EB-2011-0025**

**January 24, 2012**

## Introduction

Union Gas Limited (“Union” or the “Applicant”) filed an application on September 6, 2011 with the Ontario Energy Board (the “Board”) under section 36 of the *Ontario Energy Board Act, 1998* for an order of the Board approving or fixing rates for the distribution, transmission and storage of natural gas, effective January 1, 2012 (the “Application”). The Board assigned file number EB-2011-0025 to the Application and issued a Notice of Application on September 15, 2011.

The Application is for rates for 2012 to be set under the multi-year Incentive Rate Mechanism (“IRM”) as approved by the Board under File No. EB-2007-0606. 2012 will be the final year of Union’s five year plan.

On September 15, 2011 Union filed the evidence and a draft rate order in support of its Application.

The Board issued its Procedural Order No. 1 on October 12, 2011, in which it scheduled a number of events in the proceeding.

The Board issued its Procedural Order No. 2 on October 20, 2011, which established the Final Issues List and provided an updated List of Intervenors.

The Board held a Settlement Conference on November 1, 2011, which resulted in a partial settlement. Following the Settlement Conference, a Partial Settlement Agreement was filed with the Board on November 9, 2011.

The Partial Settlement Agreement indicated that a settlement was reached on most issues with the exception of:

- The treatment and amount proposed for Union’s Cross Bore Safety Program;
- The establishment of Deferral Account 179-127 – Pension Charge on Transition to United States Generally Accepted Accounting Principles (“USGAAP”) (“USGAAP Transition Deferral Account”);
- The closure of the Long-Term Peak Storage Services Deferral Account; and
- The wording change requested related to Union’s Late Payment Penalty Policy (combined the “Unsettled Issues”).

The Board issued a Partial Decision and Order on November 14, 2011, which accepted the Partial Settlement Agreement and ordered Union to file a revised Draft Rate Order reflecting the Partial Settlement Agreement. In the Partial Decision and Order, the Board also scheduled an Oral Hearing to hear the Unsettled Issues on January 16-17, 2012.

The Draft Rate Order was filed on November 18, 2011. Letters of comment were received from Energy Probe, the City of Kitchener ("Kitchener"), and the Canadian Manufacturers & Exporters ("CME").

The Board issued a Partial Decision and Rate Order on December 2, 2011.

At the conclusion of the oral hearing, the Board set out the process for Board staff and intervenors to make submissions on the Unsettled Issues. The Board required that submissions by intervenors and Board staff be filed by January 25, 2012 and Union reply be filed by February 1, 2012.

Board staff will make submissions on the following Unsettled Issues:

- The establishment of the USGAAP Transition Deferral Account;
- The treatment and amount proposed for Union's Cross Bore Safety Program; and
- The closure of the Long-Term Peak Storage Services Deferral Account.

## **USGAAP Transition Deferral Account**

### **Background**

Union requested that the Board approve the establishment of the USGAAP Transition Deferral Account as part of its 2012 IRM rates proceeding.

On Page 18 of Exhibit A, Tab 1 of its Application, Union explained that it is transitioning to USGAAP for financial reporting purposes as of January 1, 2012.<sup>1</sup> Union noted that as a result of the transition, a charge to retained earnings related to Other Post Employment Benefits ("OPEB") will be recorded on its financial statements.

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<sup>1</sup> See Union Gas Limited, EB-2011-0025, Application and Evidence, Ex A / Tab 1 / Page 18.

Union stated that the charge to retained earnings is made up of two components: a change in measurement date from September 30 to December 31 and a write off of unrecognized actuarial losses upon the implementation of CICA 3461.<sup>2</sup> In the Oral Hearing held on January 16 and 17, 2012, Union stated that in order to provide the comparative period financial statements, Union needed to set the retained earnings adjustment as of January 1, 2011.<sup>3</sup>

Union noted that the amount that would ultimately be recorded and disposed of in the proposed deferral account is an approximate debit amount of \$7 million to \$7.3 million.<sup>4</sup> Union stated that this amount represents the remaining unamortized amount of actuarial losses arising from the implementation of CICA 3461 - Employee Future Benefits. Union, in its argument-in-chief, proposed that the amount can be collected all at one time or over time in exactly the same manner as it would have been collected under Canadian GAAP.<sup>5</sup>

Union noted that there is no rate impact for 2012 as the annual amortization of approximately \$3.6 million, related to the noted actuarial losses, is already included in rates.<sup>6</sup> Union stated that the proposed USGAAP Transition Deferral Account will essentially be used as an accounting tracking mechanism for the time being.<sup>7</sup>

Union, in its argument-in-chief, presented the following arguments for approving the USGAAP Transition Deferral Account in the current proceeding:

- 1) The Board's approval of the establishment of the USGAAP Transition Deferral Account is the best evidence that can be provided to Union's auditors to persuade them that a regulatory asset exists for these USGAAP transition-related costs;
- 2) There is no compelling argument that it is more efficient to delay the decision on the establishment of the USGAAP Transition Deferral Account until Union's 2013 Cost of Service ("CoS") proceeding.

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<sup>2</sup> See Union Gas Limited, EB-2011-0025, Application and Evidence, Ex A / Tab 1 / Page 19.

<sup>3</sup> See Union Gas Limited, EB-2011-0025, Oral Hearing Transcript Volume 1, Page 69.

<sup>4</sup> See Union Gas Limited, EB-2011-0025, Oral Hearing Transcript Volume 2, Page 112.

<sup>5</sup> See Union Gas Limited, EB-2011-0025, Oral Hearing Transcript Volume 2, Page 117.

<sup>6</sup> See Union Gas Limited, EB-2011-0025, Interrogatory Responses, Ex. B1.8 (h).

<sup>7</sup> See Union Gas Limited, EB-2011-0025, Oral Hearing Transcript Volume 1, Page 12.

## Submission

Board staff submits that Union's argument for establishing the USGAAP Transition Deferral Account in the current proceeding is not compelling because the Board does not regulate Union's internal accounting processes or its external financial reporting. It is entirely up to the individual utility to decide how it wants to track the amounts that arise due to a transition of accounting standards and how it wants to meet its own financial reporting requirements. Board staff submits that the Board is not required to provide Union with an evidentiary basis that Union can in turn provide to its external auditors to persuade them that a regulatory asset exists related to these USGAAP transition costs. Board staff notes that, in any case, the establishment of a deferral account does not provide any assurance that approval to dispose of the balances recorded in the account will ultimately be given. Therefore, in Board staff's view, the establishment of the USGAAP Transition Deferral Account would not be strong evidence to the external auditors that the regulatory asset exists.

Moreover, the establishment of the USGAAP Transition Deferral Account is directly associated with Union's request for and the Board's determination on Union's proposed transition to USGAAP in its 2013 CoS application. Despite the fact that Union has adopted USGAAP for the purpose of external financial reporting, the Board has not yet determined whether it will allow Union to use USGAAP for the purposes of rate regulation. Board staff submits that the Board should make its decision regarding Union's request for the USGAAP Transition Deferral Account after it has made its decision on the use of the USGAAP standard for ratemaking purposes in Union's 2013 CoS proceeding (the "Preliminary Issue"). If the Board determines that Union's proposed transition to USGAAP for ratemaking purposes is not appropriate, this account, at least in its currently proposed format, will not need to be established.

In addition, Board staff notes that there is no rate impact in 2012 as the annual amortization of approximately \$3.6 million, related to the actuarial losses caused by implementing CICA 3461, is already included in rates. Board staff notes that only the balance, in the proposed deferral account, at 2012 year-end needs to be addressed as Union resets its rates in 2013.<sup>8</sup> Therefore, Board staff submits that there is no harm to Union in deferring the Decision on the establishment of the proposed USGAAP

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<sup>8</sup> See Union Gas Limited, EB-2011-0025, Oral Hearing Transcript Volume 1, Page 77.

Transition Deferral Account until after the Board makes its determination on the Preliminary Issue in Union's 2013 CoS proceeding.

Board staff submits that although it may very well be appropriate to establish the USGAAP Transition Deferral Account if Union's proposed transition to USGAAP for ratemaking purposes is ultimately accepted by the Board, the Board should not grant approval for the establishment of the USGAAP Transition Deferral Account in the current proceeding.

If the Board is inclined to grant Union approval to establish the USGAAP Transition Deferral Account in the current proceeding, Board staff submits that the Board should note in its findings that the establishment of the deferral account:

- Provides no indication at all of recovery of any of the balances recorded in the account; and
- Approval of the establishment of the deferral account has no bearing on the Board's determination with respect to the adoption of USGAAP for regulatory accounting purposes in Union's 2013 CoS application.

## **Treatment and Amount Proposed for Cross Bore Safety Program**

### **Background**

Union is proposing a Z-factor adjustment effective January 1, 2012 to allow the recovery of costs related to Union's Cross Bore Safety Program.

Union noted that the Cross Bore Safety Program was developed and implemented during 2011 as a direct result of communications with the Technical Standards & Safety Authority ("TSSA") and subsequent order dated August 31, 2011 establishing the requirement that a Cross Bore Safety Program be developed. Union stated that the Cross Bore Safety Program is designed to identify and rectify potentially dangerous situations where a natural gas line has been installed through a sewer line, as well as establish processes and procedures to minimize the risk of these occurrences happening on future installations.

In 2011, Union expects to incur \$0.800 million in O&M costs and \$1.100 million in capital costs associated with the Cross Bore Safety Program. The forecasted costs for the program in 2012 are \$1.825 million in O&M costs and \$1.100 million in capital costs. The annual revenue requirement related to the Cross Bore Safety Program is estimated to be \$1.873 million.

Union stated that the potential safety issues related to cross bores has only recently become more widely known in the utility industry as a number of serious safety incidents and explosions have occurred in the United States. Union noted that over the past 10 years, there have been approximately 25 explosions related to cross bores involving natural gas lines in the United States. Union stated that these incidents have prompted the establishment of the Cross Bore Safety Association (of which Union is a member) as well as the establishment of a Cross Bore Task team through the Canadian Gas Association ("CGA"), which Union has also participated in.

Union noted that the potential danger created as a result of a cross bore involving a natural gas line can remain undetected for years. Union noted that in many cases the gas line can remain in the sewer line without creating any issues or problems. The danger in a cross bore situation only occurs when there is a need for work to be done within that particular sewer line. In most cases, this work would be the result of a sewer line blockage or sewer line cleaning / maintenance.

Union noted that in the event of a blockage or cleaning / maintenance being required in a sewer line that contains a cross bore, the danger is created if the company or individual performing this work utilizes rotating mechanical auguring equipment or water jetting equipment in the sewer line that can potentially damage and rupture the gas line that is present. If the damage ruptures the gas line, natural gas can fill the sewer lines and potentially enter any buildings that are connected to that sewer line. If this natural gas is allowed to build up, a source of ignition may create a fire or explosion.

Union noted that during late 2010 and early 2011, it developed a Cross Bore Safety Program to address the cross bore issue and associated risks. This program was developed utilizing the CGA Cross Bore Task Team's white paper and best practices on the issues as a guideline. Union noted that implementation and communication of the program started in mid-2011 and full implementation is expected by the end of 2011.



Union noted that the Union Gas Cross Bore Safety Program was designed based on the following objectives:

- (a) Develop processes and procedures to be used during new construction utilizing trenchless technology to avoid the creation of any new cross bores.
- (b) Manage the risk associated with legacy cross bores that may already exist within the distribution system.
- (c) Proactively investigate areas of Union's natural gas distribution system that may have higher risk of cross bores.
- (d) Educate industry stakeholders, municipalities, and the general public on the issue of cross bores and raise awareness of the steps they should take prior to clearing a blocked sewer line or other work in a sewer line.

Union noted that during the spring of 2011, it implemented new construction procedures designed to be used when using trenchless technology aimed at avoiding the creation of any new cross bores. These new procedures apply to construction completed by Union's employees as well as contractors hired by Union to complete construction.

Union noted that its Cross Bore Safety Program is also designed to manage the risk associated with any legacy cross bores that may already exist in its system. Union noted that the program is essentially a response program in the event of a blocked sewer being cleared using motorized augers or water jetting equipment that could damage a natural gas line if a cross bore existed.

Union explained that prior to clearing a blocked sewer line, Union is asking plumbers, drain cleaners, sewer cleaning companies, homeowners and municipalities to call Ontario 1 Call and Union will dispatch someone to provide a locate of both the sewer line and the natural gas lines in that area to ensure no cross bore exists and the sewer clearing equipment can be safely used. Union stated that, in most cases, it is utilizing existing locate service providers to do this work supplemented with companies that have technology to conduct sewer video inspections.

Union stated that this program will be delivered to the homeowner/plumber at no charge and is aligned with its other damage prevention initiatives (i.e. Call Before You Dig) and with Enbridge Gas Distribution's program introduced a few months earlier.

Union also noted that in an attempt to identify and remove legacy cross bores; Union is proactively investigating areas in its system that may have a higher chance of a cross bore existing. Once these areas are identified, Union hires service providers with sewer video technology to camera these addresses to ensure that no cross bores exist. In the event that a cross bore is found as part of this video investigation, the cross bore will be repaired and further investigation in the area will be considered.

Union stated that the education and communication of the cross bore issue and the Union Gas Cross Bore Safety Program has and will continue to be a major focus for Union.

The approved criteria for determining whether an event qualifies for Z-factor treatment is as follows:

- (1) The event must be causally related to an increase / decrease in costs;
- (2) The cost must be outside of the control of the utility's management and not a risk for which a prudent utility would take risk mitigation steps;
- (3) The cost increase / decrease must not otherwise be reflected in the price cap index;
- (4) Any cost increase must be prudently incurred; and
- (5) The cost increase/decrease must meet the materiality threshold of \$1.5 million annually per Z- factor event (i.e. the sum of all individual items underlying the Z factor event).

Union argued that, based on the foregoing evidence, Union's Gas Cross Bore Safety Program meets the Z –factor criteria above. Union noted the following:

- (1) The increased costs incurred to develop and implement Union's Cross Bore Safety Program are a direct result of a newly identified industry issue that

was not previously accounted for or identified as part of rates. Customers have previously benefited from lower costs associated with trenchless installations and this is a related unforeseen cost that has now arisen.

- (2) This issue and the costs associated with the Union's Cross Bore Safety Program were unexpected and are required in order to comply with a TSSA Directors Order (Ref No. 1-88-11) which requires natural gas distributors to identify and incorporate procedures to manage the integrity of their systems related to this risk as well as an action plan to manage this risk. The action plan is to be completed and available for TSSA review by October 31, 2011.
- (3) The cost of Union's Cross Bore Safety Program is not otherwise reflected in the price cap.
- (4) Union's Cross Bore Safety Program was developed in alignment with the Canadian Gas Association White Paper (including Best Practices) on the cross bore issue, and in alignment with Enbridge Gas Distribution's program to ensure it incorporated best practices and alignment across Ontario. Vendors used to support Union's program were selected through a competitive bid process.
- (5) The forecasted program costs exceed the Z-factor threshold of \$1.5 million.

### **Board Staff Submission**

Board staff supports Union's claim for Z-factor treatment of its Cross Bore Safety Program. In regards to the five (5) eligibility criteria for Z-factor treatment, Board staff is in agreement with Union that the Cross Bore Safety Program meets all of the eligibility criteria as discussed above.

Board staff's only concern is in regards to Union's estimate of costs related to its Cross Bore Safety Program. Board staff is of the view that Union's cost estimate may be overstated. The assumptions used by Union to forecast the costs for its Cross Bore Safety program may turn out to be incorrect and Union could realize actual costs that are substantially lower than the forecasted costs of \$1.873 million.

Board staff notes that in its reply to the London Property Management Association interrogatory at Exhibit B8.2 (f), Union stated that if its actual revenue requirement in 2012 is below the \$1.5 million Z-factor materiality threshold it will refund the amount included in rates.<sup>9</sup> Board staff notes that no amount for Union's Cross Bore Safety Program is currently in rates as this issue was not part of a Board Decision and Order prior to the issuance of the Partial Decision and Rate Order in this proceeding. Board staff notes that, as discussed in the Settlement Agreement, if the Board determines that the costs associated with the Cross Bore Safety program qualify for Z-factor treatment under Union's current Incentive Regulation Mechanism, Union will establish the Cross Bore Safety Program Deferral Account ("CBSPDA") to track the costs of the Cross Bore Safety Program. If established, the CBSPDA will track the costs associated with the Cross Bore Safety program commencing January 1, 2012 until such time as the Cross Bore Safety program costs are built into rates.<sup>10</sup>

Board staff submits that if the actual amount for the Cross Bore Safety program (as recorded in the CBSPDA) is below the Z-factor materiality threshold, the amount recorded in the account should not be eligible for recovery as the materiality threshold will not be met.

## **Closure of the Long-Term Peak Storage Services Deferral Account**

### **Background**

Union noted that in EB-2005-0551, Union was directed to phase out the sharing of margins on Union's long-term storage transactions over four years, starting in 2008 as follows: 2008 - 25%, 2009 - 50%, 2010 - 75%, and thereafter 100%. Effective January 1, 2011, Union no longer allocates any portion of margins on Union's long-term storage transactions to this account. On that basis, Union requested approval to close the Long-Term Peak Storage Services Deferral Account effective January 1, 2012.

### **Board Staff Submission**

Board staff submits that the Long-Term Peak Storage Services Deferral Account should be closed as of January 1, 2012 as there is no longer a need for this account.

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<sup>9</sup> See Union Gas Limited, EB-2011-0025, Interrogatory Responses, Ex. B8.2 (f).

<sup>10</sup> See Union Gas Limited, EB-2011-0025, Partial Decision and Order, Appendix A – Settlement Agreement, P. 6.

All of which is respectfully submitted.