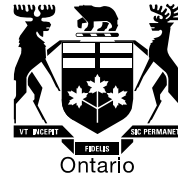


**Ontario Energy
Board**
P.O. Box 2319
27th. Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

**Commission de l'énergie
de l'Ontario**
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone: 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273



BY E-MAIL ONLY

February 3, 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 – 2013 Rebasing Application
Board File No. EB-2011-0210**

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

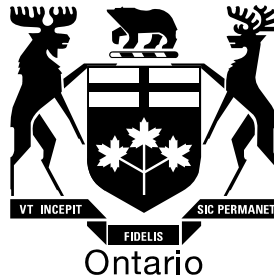
Yours truly,

Original signed by

Khalil Viraney
Case Manager

Attachments

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



ONTARIO ENERGY BOARD

BOARD STAFF SUBMISSION

Union Gas Limited

2013 Rates Application

Board File No. EB-2011-0210

February 3, 2012

Introduction

Union Gas Limited (“Union” or the “Applicant”) filed an application on November 10, 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, 2013 (the “Application”). The Board assigned file number EB-2011-0210 to the Application and issued a Notice of Application on December 1, 2011. The application was filed on the basis of US General Accepted Accounting Principles (“USGAAP”).

The Board issued its Procedural Order No. 1 on January 11, 2012, which established the approved list of intervenors for this proceeding. In addition, Procedural Order No.1 recognized the need for the Board’s determination on Union’s request for the adoption of USGAAP for regulatory purposes (the “Preliminary Issue”) in accordance with the Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment (the “Addendum Report”).

In Procedural Order No. 1 the Board established a timeline for interrogatories, interrogatory responses, submissions, and reply submissions related to the Preliminary Issue in advance of further procedural steps. In addition, the Board adopted the evidence related to the USGAAP issue from Union’s 2012 IRM Proceeding EB-2011-0025 (the “Adopted Evidence”).

Preliminary Issue – USGAAP Transition

Background

The Addendum Report noted that the Board must consider the general public interest in ensuring efficiency and consistency in utility regulation in Ontario, and will require utilities to explain the use of an accounting standard other than MIFRS for regulatory purposes. These requirements are stated as follows:

The Board requires a utility that adopts USGAAP or an alternate accounting standard other than IFRS, in its first cost of service application following the adoption of the new accounting standard, to:

- demonstrate the eligibility of the utility under the relevant securities legislation to report financial information using that standard;
- include a copy of the authorization to use the standard from the appropriate Canadian securities regulator (if applicable); and
- set out the benefits and potential disadvantages to the utility and its ratepayers of using the alternate accounting standard for rate regulation.¹

Submission

Eligibility under the Relevant Securities Legislation and Required Copy of Authorization to Use the Standard

Union has provided the decision² issued by the British Columbia Security Commission approving the use of USGAAP by Union in multiple jurisdictions (British Columbia and Ontario) for financial reporting purposes. The decision was granted for a period of three years, for Union's financial years that begin on or after January 1, 2012 but before January 1, 2015. Board staff submits that Union has demonstrated the required eligibility under relevant securities legislation, and has filed the required copy of the authorization to use USGAAP from the securities regulator.

Benefits and Potential Disadvantages

Board staff is of the view that Union's evidence supports the use of USGAAP for regulatory purposes and its proposal is in the best interests of the utility and its ratepayers.

Benefits to Ratepayers:

Union stated that the primary benefits to ratepayers for Union adopting USGAAP over MIFRS are: administrative simplicity, transparency and reduced revenue requirement.³

¹ Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, p. 19.

² Adopted Evidence, Exhibit B1.5, Attachment 3.

³ Union Interrogatory Responses, Ex. J1.1 (a).

Board staff notes that the two most relevant benefits for ratepayers are:

- 1) Reduction of 2013 revenue requirement by using USGAAP in place of MIFRS;
- 2) Rate stability.

Union stated that MIFRS requires a change in the capitalization of indirect overhead costs that would increase Union's 2013 test year revenue requirement by \$63.6 million.⁴ The comparison of 2013 revenue requirement under USGAAP vs. MIFRS was provided in Union's response to Board staff's interrogatories at Exhibit J1.1, Attachment 4. However, Board staff notes that the increase to the test year's revenue requirement resulting from a theoretical transition to MIFRS does not necessarily imply that ratepayers would pay more under MIFRS than USGAAP over the long-term. Rather, the differing capitalization criteria under MIFRS and USGAAP impact the timing of the expenses to be recovered from ratepayers.

Union also indicated that USGAAP provides more rate stability to ratepayers as USGAAP is substantially the same as Canadian GAAP ("CGAAP") currently used for ratemaking purposes.⁵ Union provided transitional impact analysis comparing CGAAP and MIFRS for 2010.⁶ Union stated that it does not expect the impacts to be materially different for 2013.⁷ Union noted that there are many accounting differences and earning impact discrepancies between CGAAP and IFRS and Union requires modifications to eliminate the resulting rate impacts. In contrast, Union noted that the only modification required for adopting USGAAP for ratemaking purposes relates to employee future benefits.⁸ Board staff notes that Union has requested the establishment of a deferral account related to employee future benefits in its 2012 IRM rate application (EB-2011-0025).

Benefits to the Utility:

Union stated that USGAAP is consistent with the basis of accounting it is already using for external financial reporting.⁹ As a result, no new adjustments and no

⁴ Union Interrogatory Responses, Exhibit J1.1 (a).

⁵ Union Interrogatory Responses, Exhibit J1.1 (a).

⁶ Union Interrogatory Responses, Exhibit J1.1 (c).

⁷ Union Interrogatory Responses, Exhibit J1.1 (c).

⁸ Union Interrogatory Responses, Exhibit J1.2 (b).

⁹ Union Interrogatory Responses, Exhibit J1.1 (a).

additional record keeping are required. In addition, Union stated that there is reduced risk of errors associated with multiple ledgers and accounting methodologies.

Disadvantages to the Utility and its Ratepayers:

Union stated that it is not aware of any disadvantages of using USGAAP as opposed to MIFRS.¹⁰

Successive Transitions of Accounting Standard and Related costs

On page 19 of the Addendum Report, the Board addresses the issue of the use of USGAAP as a short-term solution, stating:

The Board cautions utilities that the adoption of USGAAP as a short term solution may be counter-productive. If a utility is required to transition to IFRS for financial reporting purposes a few years after adopting USGAAP, certain transitional issues may not have been avoided, but delayed, and additional costs may be incurred if the utility changes its accounting standard twice. The Board will carefully scrutinize the costs incurred to accomplish two successive transitions if the utility seeks to recover these costs from ratepayers.¹¹

In regards to the issue of successive transitions of accounting standards, Union stated:

Union's plans with respect to financial and regulatory accounting upon expiry of the exemption will depend upon the status of the convergence of USGAAP to IFRS. If the accounting standards are converged, no further exemption will be required. If the accounting standards are not converged, Union will examine the facts and circumstances at that time to determine if, Union will request to extend the exemption.¹²

It is not Union's plan to convert to IFRS in the future unless IFRS is converged with USGAAP. The convergence of USGAAP to IFRS will happen over time as standards are changed. Any costs associated with changes in accounting standards are not expected to be material. In the circumstance where costs of conversion are material Union would seek recovery through a Z-factor adjustment to rates.¹³

¹⁰ Union Interrogatory Responses, Exhibit J1.1 (c).

¹¹ Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, p.19.

¹² Adopted Evidence, Exhibit B1.5 (a) iv.

¹³ Adopted Evidence, Exhibit B1.5 (b) iv.

Regarding the costs incurred by Union associated with USGAAP transition, Union stated that it is not seeking recovery of any USGAAP transition costs in this rate application and does not anticipate seeking future recovery of these costs.¹⁴ Union indicated that it has incurred costs less than \$0.100 million in 2011 for the transition to USGAAP and no additional costs are expected to be incurred.¹⁵ Board staff notes that the recovery of Union's IFRS conversion costs has been addressed in the EB-2010-0039 proceeding.

Board staff notes that Union's successive transition plan seems to depend on the status of the convergence of USGAAP to IFRS. As a result, Board staff submits that the Board cannot assess the full impact of a later transition or convergence by Union at this time. Board staff notes that the Board will have the opportunity to scrutinize the costs of the convergence if (and when) Union seeks recovery of the costs through a Z-factor adjustment to rates.

Benchmarking

Board staff notes that in the Hydro One Networks Transmission ("Hydro One") proceeding (EB-2011-0268), the Board expressed concern about the increased difficulty in benchmarking with other Ontario utilities if Hydro One transitioned to USGAAP.¹⁶ Board staff notes that Enbridge Gas Distribution has also applied to the Board (EB-2011-0354) to set rates based on USGAAP, therefore Board staff has no concerns related to benchmarking.

Conclusion

Board staff submits that Union has largely satisfied the requirements outlined in the Addendum Report:

- Union has demonstrated that it is eligible under the relevant securities legislation to report financial information using USGAAP;
- Union has included a copy of the authorization to use USGAAP from the relevant securities regulator;

¹⁴ Union Interrogatory Responses, Exhibit J1.3 (d).

¹⁵ Union Interrogatory Responses, Exhibit J3.1.

- Union has provided the benefits of using USGAAP as opposed to MIFRS for rate regulation. Union has noted that multiple modifications would be required for Union to transition to MIFRS in order to mitigate the rate impacts, while there is only one modification required upon the transition to USGAAP; and
- Union has addressed the Board's concerns regarding the costs that could be incurred by two successive transitions or overtime convergence of USGAAP to IFRS. The Board may need to address this issue in a future rate case, if and when Union files a Z-factor request for any material convergence costs.

All of which is respectfully submitted.

¹⁶ Hydro One Networks Transmission, Decision with Reasons, EB-2011-0268, pp. 13-14.