EB-2007-0606
EB-2007-0615

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

AND IN THE MATTER OF an Application by Union Gas Limited for an Order or Orders approving a multi-year incentive rate mechanism to determine rates for the regulated distribution, transmission and storage of natural gas, effective January 1, 2008;

AND IN THE MATTER OF an Application by Enbridge Gas Distribution Inc. for an Order or Orders approving or fixing rates for the distribution, transmission and storage of natural gas, effective January 1, 2008;

AND IN THE MATTER OF a combined proceeding Board pursuant to section 21(1) of the Ontario Energy Board Act, 1998.

ARGUMENT OF THE BUIDLING OWNERS AND MANAGERS ASSOCIATION OF THE GREATER TORONTO AREA, THE LONDON PROPERTY MANAGEMENT ASSOCIATION AND THE WHOLESALE GAS SERVICE PURCHASERS GROUP ON THE ISSUE OF TAXES

I. INTRODUCTION

This is the combined argument of the Building Owners and Managers Association of the Greater Toronto Area ("BOMA"), the London Property Management Association ("LPMA") and the Wholesale Gas Service Purchasers Group ("WGSPG") on the issues related to the treatment of taxes.

The Settlement Agreement with Union Gas in this proceeding dated January 3, 2008 included two unresolved tax related issues. The first of these unresolved issues is Issue 6.1 – What are the criteria for establishing Z factors that should be included in the IR plan? Under this issue it is stated that no settlement on whether tax changes resulting

from changes to federal and/or provincial legislation and/or regulations thereunder qualify as a Z factor in years 2008 and beyond.
The second unresolved issue is Issue 14.1 – Are there adjustments that should be made to base year revenue requirements and/or rates? Under this issue it is stated that that there is no settlement on the amount of taxes payable by Union as a result of tax changes to federal and/or provincial legislation and/or regulations thereunder that should be made to the base year revenue requirement.

In aggregate, the known changes in taxes that have taken place in 2007 and 2008, along with the expected changes in 2009 through 2012 total $80.51 million over the 2008 through 2012 period (Exhibit E3.1.1). As shown in this interrogatory response, there are three sources of tax changes that sum to this total. The first component is the tax related amounts related to CCA rate changes. This changes accounts for $19.27 million over the 5 year period in question. The second component is the tax related amounts related to the income tax rate changes. This component accounts for $34.05 million of the total. The third component is the tax related amount related to the capital tax rate change. This component accounts for the remaining $27.19 million.

LPMA/BOMA/WGSPG also note that the total tax impact of $80.51 million identified in Exhibit E3.1.1 is based solely on 2007 Board approved figures and does not take into account growth in utility assets and revenue. This issue was discussed by Mr. Shepherd and Mr. Birmingham (Tr. Vol. 3, pp. 181-184). Mr. Birmingham did indicate that he expect the company's taxable capital to increase over the next five years. This would lead to higher capital taxes payable than those in 2007. With the decline and elimination of the capital tax, the savings to Union will be more than those shown in Exhibit E3.1.1 since in the absence of the tax rate decline, the tax payable would increase each year. Mr. Birmingham also indicated that while taxable income can move around depending on such things as investing in asset categories with higher or lower CCA rates, generally speaking, he would expect to see an upward trend in taxable income. Again, in the absence of any of the projected income tax rate declines over the 2008 through 2012 period, this would result in Union having higher income taxes than those for 2007.

Again, since the reduction in income taxes shown in Exhibit E3.1.1 are based on Board approved 2007 taxable income, the effective reduction to Union will be higher. A lower income tax rate applied to a larger taxable income figure than that of 2007 would result in additional tax savings to Union Gas.

LPMA/BOMA/WGSPG is not suggesting that any incremental tax savings over and above the $80.51 million that Union may very well experience (due to a growing asset base, and higher taxable income over time) should be attributable to ratepayers. However, it should be pointed out that Union will have tax related savings in excess of the $80.51 million calculated. The Board should consider this in determining what portion of the $80.51 million should be allocated to ratepayers and what portion should flow to the shareholder.

LPMA/BOMA/WGSPG provides submissions below on each of these two components of the tax issue.

II. BASE RATE ADJUSTMENTS

LPMA/BOMA/WGSPG submit that base rate adjustments should be made for known tax rate changes that do or will have an effective date in 2007, Union's base rate year. There are two components to these adjustments: a decrease related to the provincial capital tax, and a decrease related to changes in the capital cost allowance rates for a number of asset classes.

a) Provincial Capital Tax

As shown in the response to an interrogatory in Exhibit E3.1.2, parties agreed to use a provincial capital tax rate of 0.285% in the EB-2005-0520 Settlement Agreement for Union's 2007 rates case (dated May 15, 2006). The Ontario government changed the rate in effect for 2007 to 0.225%. This is a reduction of more than 21%. Union has calculated the impact of this reduction to be $1.81 million in 2008 (Exhibit E3.1.1, column a, line 38). If no further capital tax reductions were to occur in the 2008 through 2012 period, this $1.81 million reduction from that included in base (2007) rates would be $1.81 million per year, or $9.05 million for the period in question. This figure represents more than 11% of the total $80.51 million in question.

As part of the EB-2005-0520 Settlement Agreement, the parties agreed ***"that in the event the anticipated tax legislation changes are not implemented or if different legislated tax changes are implemented, the impact should be subject to deferral account treatment for 2007"*** (Issue 3.14). Mr. Birmingham indicated that Union has included a credit to ratepayers of $1.8 million related to the settlement agreement for 2007 (Tr. Vol. 4, pp. 1-2). In fact, Union has brought forward this $1.8 million for disposition to customers as part their EB-2008-0034 application. However, Union is not proposing to carry this 2007 reduction in costs forward into 2008 and beyond. Mr. Birmingham states that:

> ***"But what we're saying is we're not adjusting rates going forward. We're simply recording that amount in a deferral account for a one-time disposition in accordance with the settlement agreement."*** (Tr. Vol. 4, pg. 2)

The net result of Union's proposal is that customers will benefit from the tax reduction in 2007 (through the deferral account), but then, all else being equal, they will face an increase in rates in 2008 through 2012 for a cost that no longer even exists. It is submitted that in no way could this result in just and reasonable rates for 2008 and beyond.

b) Capital Cost Allowance

The impact of the tax changes related to the changes in the CCA rates for a number of assets classes in 2007 is similar to those of the provincial capital tax above, with some exceptions. As shown in the response to Exhibit E3.1.5, the impact of the CCA rates in 2007 on the 2007 cost of service is approximately $1.0 million. Again, consistent with the EB-2005-0520 Settlement Agreement, this amount will be refunded to customers through the deferral account (Tr. Vol. 4, pp. 2-3).

The impact of the CCA rate changes in 2007 on the years 2008 through 2012 is somewhat more complicated than that of the provincial capital rate change. The provincial capital tax rate change had a quantifiable impact in 2007 and that impact is the same in each year after that, based on 2007 taxable capital. The calculation of the CCA impact, while not complicated, is somewhat more involved. This is because the CCA rate change has an ongoing impact, partly because of assets being added to these new categories with the new rates and partly because the CCA is calculated on declining balance basis. These calculations are shown in the top section of the response to Exhibit E3.1.1.

Exhibit E3.1.1 shows the impact on Class 45 (computer equipment) of moving from a CCA rate of 45% to 55% in 2007. The exhibit also shows the impact on Class 1 (distribution assets) of moving from a CCA rate of 4% to 6%, also in 2007. It should also be noted that the change in these CCA rates in 2007 are only applicable to assets purchased after March 19, 2007. As a result the CCA rate impact for 2007 of $1.0 million is based only on the assets purchased after this date, and does not reflect an annualized impact for 2007.

As shown on line 17 of Exhibit E3.1.1, the CCA difference resulting from only the change in the 2007 CCA rate grows from $4.74 million in 2008 to $11.84 million in 2012. All of these figures are based on the assumption that 2007 Board approved capital additions in 2007 would be replicated in 2008 through 2012. While this is unlikely to happen, it is likely that the actual additions to these classes will be in excess of their 2007 figures, resulting in even larger CCA differences that those reported. In any event, it is key to understand that the entire $19.27 tax related impact shown on line 20 of Exhibit E3.1.1 is related solely to the change in the CCA rates that are related to changes in 2007. There are no further CCA rate changes affecting this calculation.

The tax impact of $19.27 million is based on the declining income tax rates shown on line 18 of that exhibit. Exhibit E3.1.7 shows the same calculation, but assumes no change in the income tax rate from that in 2007 of 36.12% (line 18). With no change in the income tax rate, the CCA rate tax impact totals $24.07 million over the 2008 through 2012 period. Again, this impact is solely related to the change in the CCA rates in 2007. As discussed in more detail below, LPMA/BOMA/WGSPG submits that the Board should reduce base rates by an amount that amortizes the total impact of the 2007 CCA rate changes over the 2008 through 2012 period into an equal amount each year. Thus, if the Board determines that the $19.27 million figure shown in Exhibit E3.1.1 is the correct amount, then the amortized amount would be $3.854 million. Similarly, if the amount of $24.07 in Exhibit E3.1.7 is deemed to be the appropriate amount, then the amortized amount over 5 years would be $4.814. The choice of which of these figures is the appropriate one to use depends on the Board's decision related to the treatment of the reduction in the income tax rate as a Z factor. If the Board agrees that some or all of the income tax reductions projected for 2008 through 2012 are appropriately treated as a Z factor, then LPMA/BOMA/WGSPG submit that the $19.27 figure from Exhibit E3.1.1 is the proper amount to use, since this calculation reflects the declining income tax rates in 2008 through 2012. On the other hand, if the Board determines that the changes in the income tax rate should not be treated as a Z factor adjustment, then the amount of $24.07 calculated in Exhibit E3.1.7 is the appropriate amount to determine the reduction in base rates since this calculation does not reflect any change in the income tax rate. The amortization of either of these amounts allows the Board to do a one-time adjustment to base rates in 2008 with no further adjustments required in subsequent years since this adjustment would be built into rates on a going forward basis.

Based on the figure o $19.27 million in Exhibit E3.1.1, the CCA rate change in 2007 accounts for nearly 24% of the total $80.51 million under debate.

c) Treatment of Tax Changes in Union's Trial PBR Plan

LPMA/BOMA/WGSPG submit that the proposed base rate adjustments for the provincial capital tax and the CCA rate changes that are applicable to Union's base year rates outlined above are consistent with the Board's treatment of tax changes in Union's trial PBR plan (RP-1999-0017).

In the response provided at Exhibit E3.1.4, Union indicates that a detailed cost of service proceeding was conducted to establish rates for 2007, which were to be base rates for the incentive regulation plan term. Union further indicates that in its view, there is no difference between a 2007 tax variance and any other 2007 cost variance.

LPMA/BOMA/WGSPG submit that this is not true. There was, in fact, a tax variance account that was established for 2007.

However, regardless of the existence of the tax variance account, the Board clear in its RP-1999-0017 Decision with Reasons dated July 21, 2001 on base rate adjustments. In that case, the provincial government reduced corporate income taxes part way through 2000. The Board made a number of adjustments in costs to set base rates for 2000 which were then escalated in 2001, 2002 and 2003 under the price cap regime that was approved for Union by the Board in that proceeding. The Board made a number of key findings in that Decision that are relevant in the current proceeding. The first of these findings was that

> ***"The Board believes that it is important to establish a realistic base set of data at the commencement of price-cap PBR plan and that such data must be representative of the current operations of the utility."*** (Para. 2.165)

LPMA/BOMA/WGSPG believes this principle should be applied in the current situation. The base rates should reflect the current operations of the utility. The reduction in the provincial capital tax rate in 2007 and the increase in the CCA rates in 2007 are factors that are outside of management's control and should be reflected on a going forward basis as a reduction in rates to customers.

In paragraph 2.168 of the RP-1999-0017 Decision, the Board indicated that a number of cost reductions were sustainable, including the reduction in the provincial income tax. The Board made a reduction in the delivery revenue for base for 2000 for a number of costs, including $1.887 million related to the partial year impact of the provincial income tax reduction.

The Board also addressed the annualization of the provincial income tax change in its Decision. Specifically, at paragraph 2.169, the Board made a ***"further adjustment of $0.9 million to base delivery revenues for 2001 for the annualization of changes in provincial income tax***".

Finally, in paragraph 2.317 of the Decision, the Board stated that ***"In determine base rates, it is important to reflect the impact of known changes"***. The provincial capital tax and CCA rate changes are known changes to the base year.

The Board re-emphasized its Decision on the annualization of the income tax amount in its RP-2001-0029 Decision with Reasons dated September 20, 2002. In that Customer Review Process, Union did not intend to implement the Board's direction to decrease its base revenues by $900,000 to reflect the annualization of the corporate income tax reduction that took effect in May, 2000. The Board's Decision was clear:

> ***"The Board repeats its direction to Union to adjust its rate calculations to reflect the reduction in the revenue requirement represented by the $900,000 referenced in Paragraph 2.169 of the PBR decision. This direction should be implemented forthwith."*** (Para. 5.34).

The Board then went on to say that:

> ***"As the LPMA has pointed out, the adjustment should be "annualized" to reflect the tax cost going forward. Accordingly, Union is directed to ensure that the adjustment reflects a twelve month affect."*** (Para. 5.35)

Given the Board's previous decision related to base rate adjustments, it is submitted that the reduction of $1.81 million related to the capital tax reduction and an amortized amount of either $3.854 or $4.814 million related to the CCA rate increases is appropriate.

d) Deferred Tax Drawdown

In the response in Exhibit E3.1.4, Union indicates that the base rate adjustments that Union accepted in the settlement agreement were part of the overall agreement, and related to either items that have been dealt with by the Board in other proceedings (GDAR costs/deferred tax drawdown) or were related specifically to issues in this proceeding (regulatory cost reductions and S&T deferral account eliminations). LPMA/BOMA/WGSPG would like to draw the Board's attention to the treatment of the deferred tax drawdown which totalled $1.9 million in the Settlement Agreement in this proceeding dated January 3, 2008. This amount was based on the response to an interrogatory in Exhibit C3/C16/C33.27. As part of Union's trial PBR plan, Union proposed, and parties agreed, that the average deferred tax drawdown over the term of the IR plan should be an adjustment to base rates. The $1.9 million agreed to in this proceeding is the average of the deferred tax drawdown in each of 2008 through 2012.

This is the same approach that is being advocated by LPMA/BOMA/WGSPG for the base rate adjustment related to the CCA rate change. The average of the impact in each of 2008 through 2012 should be made as an adjustment to base rates in 2008, providing consistent treatment with that of the deferred tax drawdown to which Union agreed.

Union's response in Exhibit E3.1.4 also indicates that Union accepted the deferred tax drawdown as an adjustment to base rates because that is how it was dealt with by the Board in other proceedings. As the response to Exhibit C3/C16/C33.27 referenced above shows, this Board dealt with this drawdown in RP-1999-0017. In that proceeding the Board also dealt with the known changes in taxes as an adjustment to base rates. LPMA/BOMA/WGSPG submits that the Board should deal with the known tax changes in 2007 in the same manner as it has in the past and make these adjustments to base rates beginning in 2008.

e) Base Rate Adjustments Summary

In aggregate over the 2008 through 2012 period, the provincial capital tax reduction and the CCA rate increase that are being proposed as one-time reductions in base rates total more than $28 million (using the $19.27 figure for the CCA impact) or more than 35% of the total $80.51 million under debate. Using the higher CCA figure, the base rate adjustments would total more than $33 million, or more than 41% of the $80.51 million. The adjustment to base rates, using the average of the CCA impact over the 2008 through 2012 period would a reduction of $5.664 million ($3.854 for CCA and $1.81 for capital tax) using the lower of the CCA amounts, and $6.624 ($4.814 for CCA and $1.81 for capital tax) using the higher of the CCA amounts.

III. ADJUSTMENTS FOR 2008 THROUGH 2012 CHANGES

After adjusting the $80.51 million shown in Exhibit E3.1.1 for the base rate adjustments related to the CCA change in 2007 of $19.27 million, and the 2007 provincial capital tax reduction of $9.05, the total of the remaining adjustments is $52.19 million. The majority of this amount is the result of the tax impact from changes in the income tax rate ($34.05 million), but a substantial part is also a result of the legislated reductions and ultimate elimination of the provincial capital tax ($18.14 million) beyond the base rate adjustment amount.

The Board has heard much conjecture and theoretical musings about the lags associated with tax changes and when and by how much they impact on the GDP IPI FDD measure of inflation during this proceeding. LPMA/BOMA/WGSPG submit that the Board should take an initial step back and consider, in essence, two lags associated with the GDP IPI FDD and tax changes. The first of these lags is the regulatory lag associated with the agreed upon calculation of the inflation factor. The second of these lags is the economy lag, which is what has been much discussed by the various experts in this proceeding.

a) The Regulatory Lag

The regulatory lag is the lag between when a tax change takes place and when it can first be reflected in the GDP IPI FDD inflation factor used in the price cap mechanism. If a tax change had an immediate in the inflation factor when the tax change was implemented (i.e. no lag whatsoever) and if the tax change was fully reflected in the inflation factor, then the tax change would be reflected in the price cap mechanism as soon as the inflation factor calculation reflected the time period in which the tax change took place. In other words, a tax change effective January 1, 2008 would be reflected in the first quarter 2008 GDP IPI FDD variable, but this would not be reflected in the price cap calculation until the first quarter 2008 GDP IPI FDD was used in the calculation for a particular year.

The following table shows the quarters that will be used in calculating the inflation factor component of the price cap mechanism for Union for each of the years 2008 through 2012.

TABLE A

TIME PERIODS FOR INFLATION CALCULATION	FEDERAL TAX CHANGE	PROVINCIAL CAPITAL TAX CHANGE	RATE YEAR
July-September, 2006 October – December, 2006 January – March, 2007 April – June, 2007			2008
July-September, 2007 October – December, 2007 **January – March, 2008** April – June, 2008	Jan. 1, 2008		2009
July-September, 2008 October – December, 2008 **January – March, 2009** April – June, 2009	Jan. 1, 2009		2010
July-September, 2009 October – December, 2009 **January – March, 2010** April – June, 2010	Jan. 1, 2010	Jan. 1, 2010	2011
July-September, 2010 October – December, 2010 **January – March, 2011** April – June, 2011	Jan. 1, 2011	Jan. 1, 2011	2012

As part of the January 3, 2008 Settlement Agreement in this proceeding, Union provided a schedule (Schedule 1, page 1 of 2) that showed the calculation of the price cap index for the year ended December 31, 2008. The price cap index was 2.04% and was based on the July – September, 2006 through April – June, 2007 quarters shown in the table above.

Clearly the federal tax changes that took place January 1, 2008 cannot be included in the price cap index calculation for 2008. In fact, as shown in the table above, the January 1, 2008 tax change can only be reflected starting with the January – March, 2008 GDP IPI FDD. What this table clearly demonstrates is that the tax change that takes place at the beginning of 2008 is only partially reflected in the 2009 rate year price cap index calculation. In particular, it is only reflected in the final two quarters of the four quarters used to calculate the price cap index for 2009. The net result is that there is an eighteen month regulatory lag between when there is a tax change and when the impact of that tax change can first be reflected in the price cap index calculation. This is true regardless of whether the tax change is fully and immediately reflected in the GDP IPI FDD or whether it is reflected through some sort of distributed lag profile as postulated by Drs. Wilson and Mintz.

The dollar impact of this regulatory lag can be easily calculated based on the eighteen month timeframe and the information provided in the response to Exhibit E3.1.1. The impact of the regulatory lag can be calculated as 100% of the current year incremental tax amount and 50% of the previous year incremental tax amount calculated in Exhibit E3.1.1 of the sections that deal with the income tax rate changes and the capital tax rate changes. As previously submitted, the CCA rate section of Exhibit 3.1.1 is all related to the changes in rates that took place in 2007, and as such, there is no associated regulatory lag with this component of the tax changes.

The following table shows the calculation of the regulatory lag impact from the tax changes.

<u>TABLE B</u>

Source: E3.1.1	**2008**	**2009**	**2010**	**2011**	**2012**	**Cumulative**
Tax Related Amounts Forecast from Income Tax Rate Changes						
Line 30-Grossed-up Tax Savings	4.09	4.84	6.30	8.40	10.42	34.05
Line 31–Incremental Amount	4.09	0.74	1.46	2.11	2.02	
Regulatory Lag	4.09	2.79	1.83	2.84	3.08	14.63
Tax Related Amounts Forecast from Capital Tax Rate Changes						
Line 38–Annual Capital Tax Saving	1.81	1.81	6.34	8.61	8.61	27.19
Line 39-Incremental Amount	1.81	0.00	4.53	2.27	0.00	
Regulatory Lag (1)	0.00	0.00	4.53	4.53	1.14	10.20
(1) No regulatory lag impact for 2008 because this incremental amount is accounted for as base rate adjustment						

As the above calculations demonstrate, the regulatory lag accounts for $14.63 million of the $34.05 million (43.0 percent) associated with the income tax rate changes and for a further $10.20 million of the $27.19 million (37.5 percent) associated with the capital tax change.

In aggregate, LPMA/BOMA/WGSPG submits that the regulatory lag accounts for a total of $24.83 million, or 30.8 percent of the total $80.51 million shown in Exhibit E3.1.1. The Board should adjust rates in each of 2008 through 2012 to reflect the impact of the regulatory lag.

Union's tax related costs will decline in each of 2008 through 2012 due to the reduction in income and capital taxes that are scheduled to take place in each of these years. These are direct costs to Union and are beyond management control. They will not be reflected in the price cap index immediately due to the regulatory lag described above. As such LPMA/BOMA/WGSPG submit that this difference should be treated as a Z factor.

A Z factor is an event that has been defined in Section 6.l of the Settlement Agreement dated January 3, 2008. There are five criteria listed there. A tax change is causally related to an increase/decrease in costs and is beyond the control of the utility's management. The cost change is prudently incurred and as shown in the calculations above the associated cost change meets the materiality threshold of $1.5 million annually per Z factor event.

The only criterion in question is whether the tax change is otherwise reflected in the price cap index. Union submits that a change in taxes is fully captured in the GDP IPI FDD inflation factor. As illustrated above, even if this is true, the regulatory lag means there is an eighteen month lag between the when the direct impact on Union (i.e. the actual change in the regulatory taxes payable) and when this impact can first be captured in the applicable price cap index calculation. LPMA/BOMA/WGSPG submit that it is clear that a tax change is not reflected in the price cap index for the eighteen month regulatory lag period and as such, this should be treated as a Z factor adjustment.

The question arises as to whether the eighteen month regulatory lag associated with tax changes should be treated any differently than the regulatory lag associated with changes in other input costs. LPMA/BOMA/WGSPG submits that the answer to this question is yes, there is.

As noted above, changes in taxes are a cost that is beyond the control of the utility's management. For the majority of costs incurred by the utility, this is not the case. For example, an increase in labour costs can be managed by the utility over a short period, such as the eighteen month period associated with the regulatory lag. Management can decided to provide its employees with a smaller average increase of 1.5% as compared, for example, to 2.0%. Management can defer hiring additional employees, and they can defer replacing departing employees over such a timeframe. Moreover, management also has the option of outsourcing some of the functions performed by employees. Training expenses can be reduced on a temporary basis. Management has similar discretion with respect to capital expenditures. The timing of expenditures related to the addition or replacement of computer equipment and vehicles, for example, can be adjusted. The same cannot be said for taxes. Management has no discretion when it comes to the calculation of the taxes to be paid on a regulatory basis.

Union, or course, is free to bring forward any cost that it feels is beyond its control, subject to the materiality threshold, if it believes the eighteen month regulatory lag has a significant impact on their operation.

b) The Economy Lag

The economy lag is the lag between when a tax change is implemented and when the change is reflected in the GDP IPI FDD. In effect, it is an add-on to the regulatory lag discussed above. If the tax change is immediately reflected in the price index, as is the case with a change in the GST or in a retail sales tax, then the economy lag is zero. On the other hand, if a change in a tax takes time to filter through the economy, the lag can be considerably longer.

The undertaking response provided at Exhibit K7.1 shows the impact on the GDP IPI FDD inflation measure of the corporate tax changes that take place in 2007-2008 through 2010-2011 at lines 9 through 14 of each of the three scenarios attached. In all three cases, the economy lag shown by Union's experts is at least one year. This can be seen, for example, in line 9 of Table 1 where the tax change impact of 2007-2008 (i.e. tax changes in 2008 relative to 2007) do not have any impact in 2008. Moreover, the impact in the following year, 2009, is very small at only -0.02% relative to the impacts in subsequent years. This pattern is repeated in lines 10 through 12. In each case, there is no impact on the GDP IPI FDD until the year following the year in which the tax changes take place.

Union's witnesses have provided clear evidence that the economy lag, in their opinion, is at least one year long. Using this as the economy lag on top of the regulatory lag, the impact on the tax figures can be easily calculated, as shown in the table below. The impact of the one year economy lag starting at the end of the regulatory lag can be calculated as 50% of the previous year incremental tax amount and 50% of the incremental amount in the year before that. These amounts are calculated in Exhibit E3.1.1 of the sections that deal with the income tax rate changes and the capital tax rate changes

TABLE C

Source: E3.1.1	**2008**	**2009**	**2010**	**2011**	**2012**	**Cumulative**
Tax Related Amounts Forecast from Income Tax Rate Changes						
Line 30-Grossed-up Tax Savings	4.09	4.84	6.30	8.40	10.42	34.05
Line 31–Incremental Amount	4.09	0.74	1.46	2.11	2.02	
Economy Lag	0.00	2.05	2.42	1.10	1.78	7.35
Tax Related Amounts Forecast from Capital Tax Rate Changes						
Line 38–Annual Capital Tax Saving	1.81	1.81	6.34	8.61	8.61	27.19
Line 39-Incremental Amount	1.81	0.00	4.53	2.27	0.00	
Economy Lag (1)	0.00	0.00	0.00	2.27	3.40	5.66
(1) No economy lag impact for 2008 and 2010 because the incremental amount on 2008 is accounted for as a base rate adjustment						

A simple example illustrates the one year economy lag in addition to the eighteen month regulatory lag. As the example, take the impact in 2011 for the tax related amounts related to the income tax changes. The grossed-up tax savings for that year are $8.40 million. The regulatory lag, calculated in Table B is $2.84 million and the economy lag calculated above in Table C is $1.10 million. In aggregate these two lags total $3.94 million. This figure can also be directly calculated from Line 31 – incremental amount in Table B or C above as 100% of the 2011 figure, 100% of the 2010 figure and 50% of the 2090 figure, representing the total combined lag of 2.5 years.

As the figures in Table C demonstrate, the one year economy lag represents $7.35 million or 21.6 percent of the income tax changes and $5.66 million or 20.8% of the capital tax changes.

In aggregate, LPMA/BOMA/WGSPG submits that the one year economy lag accounts for a total of $13.01 million, or 16.2 percent of the total $80.51 million shown in Exhibit E3.1.1. The Board should adjust rates in each of the applicable years to reflect the impact of the one year economy lag.

There is also justification, in the view of LPMA/BOMA/WGSPG to use an economy lag in excess of 1 year. This is because Union's experts have indicated that in addition to not having an impact on the inflation factor in the first year, they believe that there is a distributed lag impact on the inflation factor that is likely somewhere between seven and ten years long. If this is accurate, then the average economy lag is likely 2 to 3 times longer than then one year used for the calculations in Table C.

The issue has been raised of whether or not there should be an adjustment to the Z factor treatment of tax changes in 2008 through 2012 to take into account tax changes that have taken place in the past, up to and including 2007. Union contends that they would be treated unfairly if there is a Z factor adjustment for future tax changes, but no Z factor treatment for past tax changes. The rationale for this is that past tax changes have an impact on future inflation factors meaning that the inflation factor is lower than it would have been in the absence of the tax cuts of past years.

LPMA/BOMA/WGSPG submits that this view has not been supported by Union. Indeed, the evidence related to the Bank of Canada policy to maintain inflation within a targeted range would suggest that inflation would not be significantly different in the absence of the past tax cuts.

More importantly, the impact on the inflation rate from past tax reductions appropriately reflects the impact on Union. This impact is a lower inflation rate going forward than if the tax reductions had not taken place. This is, according to Drs. Wilson and Mintz, because the impact of lower taxes is to increase capital investment that ultimately leads to productivity improvements. This process takes time, but ultimately leads to lower unit costs for the business community. These lower costs are passed through the economy, moderating any increase in the GDP IPI FDD.

LPMA/BOMA/WGSPG believes that the cost impact on Union needs to be looked at in two parts. The first part is the direct reduction in taxes payable by Union as a result of the tax reductions. The second part is the indirect impact on Union's input costs which are impacted by the reduction in the GDP IPI FDD. Ms. Chaplin discussed this concept in general with Mr. Birmingham (Tr. Vol. 4, pp. 70-74).

Past tax changes are no different than other past changes in the factors that affect unit costs such as changes in technology. The key point is that regardless of the reasons for the change in unit costs, these changes are reflected in the GDP IPI FDD going forward. But this means that there is an indirect impact on the cost of inputs for businesses, including Union. The end result is lower input costs, as reflected by the GDP IPI FDD, for all businesses, including Union.

As a result, it is submitted that there is no double counting by treating future tax changes as a Z factor while not adjusting for past tax changes. The past tax changes result in lower costs to Union. The future tax changes will also eventually provide lower costs to Union for its inputs. In the meantime, however, Union has a direct and measurable reduction in its costs in the interim. Thus the rationale for the need for the regulatory lag and economy lag Z factor adjustments.

Consider also the following scenario. Instead of declining taxes in the 2000 through 2007 period, taxes rise in this period. The declines projected for 2008 through 2012 are still expected. As a result, there was a period of increasing taxes, followed by a period of declining taxes. In the first few years of the IR term, the inflation rate would be higher than it would otherwise be because of the past tax increases and because the current tax decreases would not yet be reflected in the price cap index calculation (due to both the regulatory lag and the economy lag). In this period, therefore, Union's rates would be increasing at a faster pace because of the increase in the GDP IPI FDD, while at the same time their tax cost would be declining, reflecting the direct and immediate impact of declining tax rates. It is submitted that in this case, it would not be appropriate to have Union benefit from higher rates due to higher taxes in the past, and pocket the immediate savings related to lower current taxes. Taxes are clearly beyond the control of management and should be treated as a Z factor event. The same treatment should be given to taxes in this current situation of where past tax decreases are followed by further tax decreases.

LPMA/BOMA/WGSPG notes that in the response provided in Exhibit K7.1, it is postulated that Union's price cap will be reduced by the effect of the GST reduction that took place at the beginning of 2008. While this may be true, the response also indicates that Union experiences no corresponding reduction in costs. This, of course, is not true. The working cash allowance component of rate base includes a component directly related to the GST. In the EB-2005-0520 proceeding that set Union's base rates for 2007 included a rate base allowance of slightly more than $4 million related to the GST. This information can be found in Exhibit B3, Tab 3, Schedule 2 of that filing. Specifically, Union calculated a working cash allowance requirement of $4.024 million (line 5 plus 11). This calculation was based on the then existing GST rate of 7%. With the GST now at 5%, the reduction in the working cash allowance requirement is 2/7th of this amount, or approximately $1.15 million.

The response provided by Union Exhibit K7.1 also fails to mention the positive impact on average use and consumption in general of the reduction in the GST rate that ratepayers have to pay. The GST reduction is effectively a reduction in the cost to ratepayers relative to what they would otherwise be paying.

IV. SUMMARY

In summary, LPMA/BOMA/WGSPG submit that the following adjustments should be made to Union's rates through either a base rate adjustment or a Z factor adjustment:

TABLE D

Base Rate Adjustment – Capital Tax	$9.05
Base Rate Adjustment – CCA	$19.27
Regulatory Lag – Income Tax	$14.63
Regulatory Lag – Capital Tax	$10.20
One Year Economy Lag – Income Tax	$7.35
One Year Economy Lag – Capital Tax	$5.66
Total	$66.16

In aggregate, these base rate adjustments and Z factor amounts represent approximately 83% of the $80.51 million total shown in Exhibit E3.1.1. This share would be larger if the alternative CCA figure of $24.07 was used or if the Board were to determine that the effective economy lag was longer than one year in length.

V. IMPLEMENTATION

The issue of implementation deals with whether the Board should implement the base rate adjustments and the Z factor adjustments based on the current information available or on an annual basis in order to reflect actual tax changes that take place.

LPMA/BOMA/WGSPG submits that this should be done on a case by case basis. The base rate adjustment associated with the 2007 capital tax decrease is known and can be implemented as a reduction to 2008 rates. The CCA related base rate adjustment is a little more problematic, since the five year amount depends on the marginal tax rate in each of 2008 through 2012. It is submitted that the Board can make a determination of this amount based on the current information available. If one or more the marginal tax rates is different from that currently projected, the difference should be brought forward as a separate Z factor adjustment in the future, subject to the materiality threshold. There is no CCA issue if the Board determines that changes in the income tax rate should not be treated as a Z factor. Under this circumstance, the higher CCA amount should be applied and this amount will not change since it is based on the 2007 marginal tax rate of 36.12%.

With respect to the projected changes in the income tax rates and the capital tax rates in 2008 through 2012, there is some uncertainty, of course, as to whether these projections will be accurate. The actual tax rates applicable to those years may be higher or lower than the current expectations. It is submitted that the Board should calculate the Z factor amount on a prospective basis based on the most recent information when Union files its application. Any changes that impact on this amount should be tracked through a variance account for true up after the fact. This ensures that neither ratepayers nor the shareholder are disadvantaged by unexpected tax changes, which of course, is the purpose behind a Z factor adjustment. This is a similar approach that was taken with Union in their 2007 rates case (EB-2005-0520) as part of the Settlement Agreement in that proceeding.

VI. COSTS

LPMA/BOMA/WGSPG request that they be awarded 100% of their reasonably incurred costs of participating in this proceeding.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 14th day of April, 2008.

BUILDING OWNERS AND MANAGERS ASSOCIATION OF THE GREATER TORONTO AREA
&
LONDON PROPERTY MANAGEMENT ASSOCIATION
&
WHOLESALE GAS SERVICE PURCHASERS GROUP

By their Consultant

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