



EB-2008-0292

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

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

BEFORE:

Pamela Nowina Presiding Member and Vice Chair
Paul Sommerville Member
David Balsillie Member

DECISION ON MOTION

December 10, 2008

INTRODUCTION

On August 28, 2008 Union Gas Limited ("Union") filed a Notice of Motion (the "Motion") for a review and variance of the Ontario Energy Board's (the "Board") Decision and Order ("Decision"), file number EB-2007-0605/0615, dated July 31, 2008, pursuant to Rule 44 of the Board's Rules of Practice and Procedure. The Motion requested clarification of certain Decision particulars pertaining to the Risk Management Program and the Treatment of Tax Changes, and if appropriate variance of the Decision.

The Board heard the Motion on November 10, 2008.

TREATMENT OF TAX CHANGES

Background and Findings

In EB-2007-0606/0615 the Board made a determination that the savings attributable to the reduction in certain taxes are to be shared in equal measure between Union and its ratepayers.

This decision was made after a focused hearing characterized by detailed expert evidence addressing the question as to how much of the tax savings produced by the reductions in tax rates would be captured by the chosen inflation factor, the Gross Domestic Product Implicit Price Index Final Domestic Demand ("GDP IPI FDD"), during the course of the Incentive Regulation Mechanism ("IRM") plan. Union is nearing the end of the first year of the five year plan. The Board's decision to treat 50% of the savings as a Z factor is documented in the Board's decision, but in summary, recognized that not all of the savings attributable to the tax reductions would be captured by the inflation factor and that therefore fairness required that the savings be shared in equal portions between Union and the ratepayers.

Union's request for clarification in this proceeding focuses on the extent to which this sharing ought to extend to capital additions made during the course of the IRM plan. Union's position is that no portion of the tax savings resulting from the application of the increased capital cost allowances to capital additions made during the course of the IRM plan ought to be subject to the Z factor mechanism. The rationale for this position is that the new capital additions made throughout the IRM plan are not part of the original rate structure for the IRM plan. Union asserts that its IRM plan is founded on 2007 base rates, and that the capital additions made after that point are really outside of the scope of the Z factor treatment mechanism.

Union's proposal is opposed by six intervenors. While each of the intervenors opposing the proposal approaches the question somewhat uniquely, they all agree on the central point and insist that the Z factor sharing of the tax savings was intended to extend to the new capital additions made during the term of the IRM plan.

The issue is material. Union proposes that the tax saving in question should be about \$65 Million. This is predicated on Union's proposal to exclude new capital additions from the calculation of the tax savings subject to sharing.

If the Board accepts the intervenors' view, about \$80.5 million should be subject to the 50/50 sharing. This number is based on including new capital additions when calculating the tax savings subject to sharing.

For the reasons below the Board finds that the Board in its previous Decision intended that the tax savings to be shared and subject to Z factor treatment extended to capital additions made during the term of the plan.

The Board's analysis of this question begins with the observation that the Decision under review did not in any specific way address the issue in question. As noted above, EB-2007-0606/0615 dealt in great detail with the question of how much of the anticipated tax savings would be captured in the selected inflation factor. It did not explicitly address the question of how new capital additions ought to be accounted for.

In some respects this request for clarification addresses issues not directly relevant to the tax case at all, but rather the architecture of the IRM plan itself, which was established by way of settlement in EB-2007-0606/0615.

The Board therefore must consider Union's request for clarification in light of all of the circumstances surrounding the IRM plan itself and the Board's findings in the tax case. In other words, in providing the clarification requested, the Board must place Union's proposal within the broader context of the IRM plan and the Z factor sharing mechanism and determine which approach is most consistent with the Board's expectations in previous findings.

While the Decision under review did not directly address the question of future capital additions, there were elements in that case which provide guidance in our consideration of the issue.

In that case, in response to an interrogatory from an intervenor, Union produced a schedule, identified as Exhibit E3.1.1 entitled "Estimated Tax Rate Change Impacts (2008-2012)". This schedule reflected Union figures estimating the quantum of savings attributable to the changes in tax rates referenced above. The schedule substantially imitated a similar schedule that had been produced by Enbridge Gas Distribution Inc. ("Enbridge") for the purposes of its IRM plan. Unlike Union, Enbridge agreed as part of its settlement in the IRM case to share the expected savings with ratepayers.

Exhibit E3.1.1 reflects a tax saving amount of \$80.5 million over the course of the Union IRM plan. The schedule describes the effect for Union of the reductions, and breaks them out to show savings attributable to reductions in the corporate income tax rate, the capital tax rate, and most importantly for our discussion, changes to the capital cost allowance rates.

This schedule reflects new anticipated capital additions to be made in each year of the IRM plan, 2008 to 2012 inclusive. Lines 2,6,10 and 14 of Exhibit E3.1.1 contain entries for new purchases during the period. It is these new purchases, that are new capital additions, that Union seeks to exclude from the operation of the Z factor sharing mechanism.

Union rests its argument in large part on the language the Board used to describe the effect of Exhibit E3.1.1. In its decision, which as noted above did not explicitly address the question of new capital additions, the Board referred to the approach reflected in Exhibit E3.1.1 as "indicative" of the approach that Union should follow with respect to the content of the Z factor sharing mechanism. Union suggests that because the Board used the word "indicative" that it did not intend each entry of Exhibit E3.1.1 to be definitive with respect to the issue. Therefore, according to Union, its proposal for the exclusion of new capital additions is not inconsistent with the Board's decision, because the Board's decision was not definitive.

The Board finds otherwise. It is clear from the language of the decision in EB 2007-0606/0615 that the Board's decision to allocate 50% of the savings to ratepayers was not based on the Enbridge precedent. However, the Board clearly regarded Exhibit E3.1.1 as the appropriate approach for the proposed handling of the sharing of the tax savings. If the Board intended to exclude new capital additions from the scope of the sharing mechanism it would have explicitly done so. It would have provided direction to Union to exclude new capital additions.

Several parties stated that if it were Union's intention to exclude these capital additions from the scope of the sharing mechanism, it should have indicated this in EB-2007-0606/0615. The Board agrees. The Exhibit clearly included entries for new capital additions and Union witnesses did not comment on or object to that inclusion. Union had the opportunity to raise this issue when it prepared the Exhibit, or during the course of its evidence in the case, or finally as part of its submissions. It did not. Union's primary observation about the Exhibit was that the savings calculation should have been predicated on actual amounts, not the pre-set amounts reflected in the Exhibit.

This failure to raise the issue is particularly telling in the context of a motion to review. The Board's Rules respecting reviews direct the reviewing panel to consider the extent to which the applicant's request for review is based on new or reasonably undiscovered material. In this case, Union could have raised its concerns respecting the inclusion of new capital additions at any one of the opportunities it had to do so.

The Board also considers Union's position in this case to be inconsistent with the Board's view of the appropriate structure of the IRM plan. IRM plans are designed to achieve a number of regulatory goals. It is hoped that the plans provide an appropriate incentive for utilities to pursue and implement efficiencies. Plans are also intended to provide reasonable protection for ratepayers, while reducing regulatory burdens and costs. As noted above, Union's IRM plan was the product of a settlement agreement between a range of highly experienced and diverse ratepayer interests and the utility.

Union's proposal in this case treats new capital additions made during the course of the IRM plan, as a distinct and severable aspect of its operation. Excluding these expenditures from the operation of the Z factor sharing plan would, in effect, be segregating these expenditures from the operation of the IRM plan per se. In the Board's view this is inconsistent with our expectation as to how the IRM plan operates.

In the Board's view, the establishment of base rates in 2007 is thought to incorporate the whole range of typical, unextraordinary utility operations. The examination of utility operations conducted at rebasing forms the bedrock of the IRM plan. Pursuant to the plan, the appropriate inflation factor and productivity factor are applied to those base rates to arrive at rates for each year of the plan. The base rates established for 2007, which formed the basis for all of the rates going forward under the plan, incorporated capital spending of the kind that would be subject to the changes in capital cost allowances referenced above.

The IRM plan encompasses capital spending made during its course. Union's IRM plan is predicated on an expectation that capital spending in the usual amount will be made year-over-year during the currency of the plan. Union is compensated for the normal ebb and flow of items into and out of rate base over the term of the plan. The 2007 rates capture a "normal" experience of additions to and retirements from rate base. New capital additions, precisely of the kind Union seeks to exclude from the operation of the Z factor sharing mechanism, are anticipated within the plan. As noted earlier, Exhibit E3.1.1 contains line items specifically related to new purchases year-over-year, during the course of the IRM plan, that is, from 2008 to 2012 inclusive. As a general rule it is inappropriate to extract revenue or spending items that would arise in the normal course of utility operations during the course of an IRM plan.

The appropriate approach is to use the figure appearing in the 2007 rates case respecting budgeted expenditures for Computer Equipment (Class 45) and Distribution Assets (Class 1). While Union's witnesses suggested that actuals should be used, reflecting additions made over the course of the previous year, that is not the correct approach. The levels reflected in the 2007 rates case are considered to be representative of such expenditures year over year during the plan. The Board finds that these are the numbers that should be used to calculate the shared savings arising from the increased capital cost allowances. However, the amount of tax savings subject to sharing and Z factoring would differ if the actual tax rate changes differed from the tax rates reflected on Exhibit 3.1.1.

This approach of using the pre-set amounts established in the 2007 rates case, as opposed to actuals, as the basis of the calculation is consistent with the Board's views as expressed in the third generation IRM report. While that report deals exclusively with the application of an incentive rate mechanism for the electricity utilities in Ontario, its principles apply equally to Union's IRM.

RISK MANAGEMENT

Background and Findings

In this proceeding Union also seeks clarification with respect to its treatment of the costs associated with its risk management program. In EB-2007-0606/0615 the Board found that the costs associated with Union's risk management program ought not to be recovered from ratepayers. Associated with this request for clarification was a finding

that Union's rolling 24 month fixed-price purchase plan was not part of Union's financial hedging activity, and therefore this plan stood outside of the Board's disallowance with respect to the balance of Union's hedging activities. In addition, Union sought guidance from the Board with respect to how to reflect the disallowance ordered by the Board.

There were seven intervenors on this Motion. Four had "No comment" on the risk management aspect and three were in support of Union's position.

The Board recognizes that Union's 24 month fixed-price purchase plan was in fact not part of Union's supply strategy, but rather was accomplished by means of financial instruments. Accordingly, as proposed by Union, this program should also be discontinued along with the remainder of the financial hedging activities addressed in the Board's decision in EB-2007-0606/0615.

Further the Board acknowledges and confirms that the cost disallowance made by the Board is limited to the costs related to the administration of the program, and not to the outcomes of the trades associated with the hedging activity. The Board also acknowledges that the appropriate method to reflect the disallowance is through a reduction in the annual gas supply administration charge equivalent to the administration costs (\$103,831) associated with the hedging activity, and not through a deferral account.

COSTS

A decision regarding cost awards will be issued at a latter date. Eligible intervenors claiming costs should do so as ordered below.

The Board hereby directs:

1. Intervenors eligible for cost awards shall file with the Board and forward to Union their respective cost claims within 14 days from the date of this Decision.
2. Union may file with the Board and forward these intervenors any objections to the claimed costs within 28 days from the date of this Decision.
3. Intervenors, whose cost claims have been objected to, may file with the Board

and forward to Union any responses to any objections for cost claims within 35 days of the date of this Decision.

4. Filings are to be in the form of two hardcopies and one electronic copy in searchable PDF format at boardsec@oeb.gov.on.ca and copy Union Gas Limited.

Union shall pay any Board costs of, and incidental to, this proceeding upon receipt of the Board's invoice.

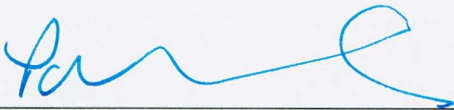
DATED at Toronto, December 10, 2008.

ONTARIO ENERGY BOARD



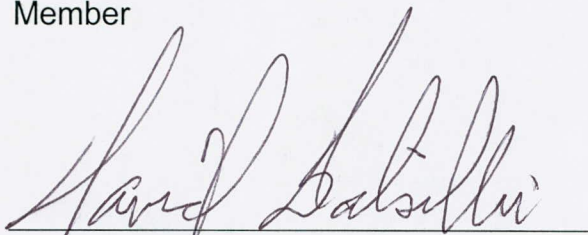
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David Balsillie

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