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ONTARIO ENERGY BOARD **FRASER MILNER CASGRAIN LLP**

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VIA E-MAIL

April 14, 2008

15/4/08
Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, Suite 2700
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

**Re: Union Gas Limited;
2008-2012 Rate Application;
Board File No EB-2007-0606**

I am writing on behalf of Enbridge Gas Distribution Inc to file the Final Argument of Enbridge on the issue of the treatment of tax rate changes during the term of Union's incentive regulation plan.

Yours very truly,

Helen T. Newland.

HTN/ko

cc: All Intervenors

ONTARIO ENERGY BOARD

IN THE MATTER of the *Ontario Energy Board Act*, 1998, S.O. 198, c.15, Schedule B, as amended;

AND IN THE MATTER OF an Application by Union Gas Limited 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 January 1, 2008.

Final Argument

on behalf of

Enbridge Gas Distribution Inc.

Introduction

1. Enbridge Gas Distribution Inc. ("Enbridge") is an intervenor in the proceeding to hear and decide the application of Union Gas Limited ("Union") for approval of its incentive regulation plan ("IR Plan"). This argument is submitted on behalf of Enbridge as an intervenor, in respect of certain tax-related issues that were not included in Union's Partial Settlement Agreement (the "Union Settlement").
2. There are two outstanding tax-related issues. The first is whether an adjustment to Union's 2007 base rates should be made for tax rate changes that became effective in 2007 but which were not reflected in the cost forecasts underpinning these rates. The second is to what extent changes in tax rates that are expected to occur within the term of Union's IR Plan are captured in the inflation factor component (the "GDP deflator") of the price cap formula. A corollary of the second issue is whether the tax rate changes that will be applicable to Union during the term of the IR Plan should be passed on to ratepayers through a Z-factor adjustment.

3. Enbridge's argument on tax rate changes is limited to submissions on the second issue: the need, or not, for a Z-factor adjustment to reflect three different tax rate changes: changes in the federal corporate tax rate, changes in the depreciation rates of certain capital assets for the purpose of calculating "undepreciated capital cost" for federal income tax purposes and certain changes to the Ontario capital tax (collectively, the "Tax Cuts").

Enbridge Has Settled the Tax Cuts Issue

4. The issue of how the Tax Cuts should be treated also arose in the context of Enbridge's application for approval of its own incentive regulation plan. Unlike the Union case, the Tax Cuts issue was included as part of the Enbridge Partial Settlement Agreement that was reached with intervenors and which was approved by the Board on February 11, 2008 ("the "Enbridge Settlement").
5. In participating in the Union case and making this submission, Enbridge is in no way resiling from the disposition of the Tax Cuts issue in the Enbridge Settlement. Nor is it expecting or asking that the disposition of the issue in the Union case be made applicable to Enbridge, during the term of its own incentive regulation plan. Nevertheless, there are important matters of principle and policy at stake in this proceeding that have ramifications beyond the initial term of each utility's incentive regulation plans and Enbridge is entitled to be heard on these matters.

The Enbridge Settlement Has No Precedential Value

6. The disposition of the Tax Cuts issue in the Enbridge Settlement is intricably linked to the disposition of all of the other matters that were at issue in the Enbridge case. The parties who agreed to the settlement, settled all of the issues as a package; none of the parts of this package are severable.
7. In the result, the disposition of the Tax Cuts issue in the Enbridge Settlement does not necessarily reflect the position that each party would take on this issue on a stand-alone basis. It is simply a negotiated and compromised resolution of one issue, having regard to the resolutions reached on other issues.

8. That settlement agreements have little or no precedential value was affirmed by the Board in its decision on a recent Hydro Ottawa settlement:

In so finding, the Board has noted Staff's submissions pertaining to deferral accounts. Settlement proposals are a result of a complex relationship of issues. One should not look for precedential value with respect to specific elements of the settlement agreement in this case.

It is the overall cost consequence or rate outcome that the Board accepts, not necessarily the results of specific methodologies or proposals that may or may not deviate from Board regulatory instruments that may otherwise apply. (EB-2007-0713, Settlement Hearing, p. 42)

9. This decision and proposition was subsequently referred to and relied on by the Board in its decision on the procedure that should pertain to hearing and deciding the Enbridge Settlement [1Tr. 108-109].

Tax Cuts Do Not Meet Z-Factor Criteria

10. Enbridge submits that the Tax Cuts should not be passed through as Z-factor adjustments. It takes this position for four reasons.
11. The first reason is that the Tax Cuts do not meet one of the five criteria for Z-factor treatment that were agreed to in the Union Settlement; namely, that the cost increase/decrease at issue must not otherwise be reflected in the price cap index. Evidence to this effect was authored by Drs. Mintz and Wilson, on behalf of Union. Drs. Mintz and Wilson are acknowledged world-renowned experts in tax and fiscal policy. While their evidence was strenuously challenged during cross-examination, it was not successfully refuted. Indeed, the Board Staff's expert, Dr. Lowry, characterized the responses of Drs. Mintz and Wilson to the evidence of Drs. Loube and Georgopoulos as "persuasive" [6Tr. 66] and concluded that there could be little question that the GDP

deflator would pick up a "substantial portion" of the effect of a pervasive tax cut such as is under consideration in this case [6Tr. 61].

12. There was much debate during cross-examination of the expert witnesses in this proceeding about the appropriateness of taking into account the impact of Tax Cuts from prior periods (i.e., prior to 2008) on the GDP deflator during the term of the IR Plan: the so-called "lag effect." Drs. Mintz and Wilson included these lag effects in their analysis that concluded that the impact of Tax Cuts did flow through to the GDP deflator during the IR Plan.
13. Some intervenors suggested that including lag effects was contrary to rate-making principles. Others suggested that it would amount to "double-counting" and result in a windfall to Union.
14. It seems to Enbridge that if lag effects are not taken into consideration, Union will be the victim of some degree of double counting: once, at the time it rebased when it made forecasts of costs that took into account the impact on its costs of in-period Tax Cuts and, again, during the term of its IR Plan, when the impact of these very same Tax Cuts eventually flow through to the GDP deflator.
15. Moreover, all of the experts in this proceeding agreed that the lag effects of prior period Tax Cuts would put downward pressure on the GDP deflator during the term of the IR Plan. Indeed Dr. Lowry, the only expert in incentive regulation to testify in this proceeding, testified that it was legitimate for the Board to consider lag effects [6Tr. 62]. If these effects are ignored, it is the ratepayers who will enjoy a windfall.

Incentive Regulation, Not Cost-of-Service

16. The debate on whether or not lag effects should be taken into account highlights the second reason why Enbridge says that the Tax Cuts should not be Z-factored; namely, that incentive regulation should not entail the matching, on an exact a dollar-for-dollar basis, of in-period costs against in-period revenues. During the term of any incentive regulation plan, some costs will change more and others will change less than the year-over-year change in the inflation factor. This will be especially true with respect to goods

and services whose prices are set in world markets. It is the job of the utility to manage these costs fluctuations. The most obvious way this can be done is to offset greater-than-inflation price increases against less-than-inflation increases. This is how incentive regulation is supposed to work.

17. Dr. Lowry testified that generally speaking under incentive regulation, once base rates are set they should not be changed even if they become "a little stale" over time. Some costs changes which are outside the control of the utility will benefit the utility; some will hurt it. That's the nature of incentive regulation.
18. During cross-examination, some intervenors characterized the revenue requirements amount associated with the 2008-2012 tax cuts as a "windfall" to Union; others saw it as an amount "owed" to ratepayers. In its final Argument, School Energy Coalition goes further, characterizing it as "[t]he government hands the utility the money." With respect, Enbridge submits that parties who advance this argument have one foot tentatively in incentive regulation and one foot firmly planted in cost-of-service regulation.

Tax Policy Should not be Reversed by Regulatory Decisions

19. The third reason why Enbridge submits that the Tax Cuts should not be Z-factored has to do with the tax policy that underpins the Tax Cuts; namely, the desire on the part of the federal and Ontario Ministers of Finance to stimulate investment by decreasing the cost of capital.
20. If the Board were to Z-factor the Tax Cuts, it would be doing what the federal and Ontario Ministers of Finance chose not to do. If they had wished to hand consumers a rebate, they would have done so directly by reducing sales taxes. They did not do this and the Board should not either.

No Empirical Evidence to Determine Z-Factor

21. The only expert on incentive regulation to give evidence in this proceeding – Dr. Lowry – testified that while Z-factors may make for more precise results, they greatly complicate matters which is contrary to one of the objectives of incentive ratemaking [6Tr. 60].

Moreover, he noted that solid evidence of the need for a Z-factor is required to ensure that double counting is avoided. As there is no empirical evidence to support the choice of any particular Z-factor number, Dr. Lowry was of the view that the Board should stay away from Z-factors for Tax Cuts. Dr. Lowry noted that even if one were to conduct an empirical or simulated model study, the results would be unreliable. Interestingly enough, School Energy Coalition's own expert witness also noted the absence of any empirical data.

22. Finally, Dr. Lowry noted that even if the Board were to decide to enter into these unchartered waters and land upon a Z-factor amount that would not be the end of the story. A decision to Z-factor Tax Cuts during the term of the IR Plan means that the Board will have to give Union a Z-factor in any subsequent IR period to take into account the lagged tax effects that were taken away from Union given to ratepayers in the initial term.

ALL OF WHICH IS RESPECTFULLY SUBMITTED on behalf of Enbridge Gas Distribution Inc., by its counsel, this 14th day of April 2008


Helen T. Newland