

K3.1

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DECISION WITH REASONS

RP-2001-0029

**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 or fixing just and reasonable rates and other charges for the sale, distribution, transmission, and storage of gas for periods commencing January 1, 2001, and January 1, 2002;

**AND IN THE MATTER OF** the customer review process and other mechanisms approved by the Ontario Energy Board in its decision in RP-1999-0017.

**BEFORE:** Malcolm Jackson  
Presiding Member

George A. Dominy  
Member

Paul B. Sommerville  
Member

**DECISION WITH REASONS**

September 20, 2002

Ontario Energy Board	
FILE No.	<u>EB-2007-0606/0615</u>
EXHIBIT No.	<u>K 3.1</u>
DATE	<u>March 31, 2008</u>
<u>Excerpts of materials from Union</u>	
08/99	

*Board Findings*

- 5.29 There may be instances where a tax change is of such a nature that it may warrant treatment as a Z factor. Such a case may arise when a tax change is of such special and unique application to Union that it could not reliably be expected to be reflected in a Canada-wide index such as the GDPPI. It may also be true that the parties, when assessing the current PBR plan and designing its successor, will want to consider alternate methodologies for determining the inflation factor.
  
- 5.30 The Board notes that the use of an actual GDPPI, which the Board has chosen for expediency and to avoid significant debate within a CRP, means accepting that changes in other costs too may have a lag affect on rates. Its fairness over time would appear to rely on consistently using the same approach, including consistently choosing comparable data on which to base the I-factor determination.
  
- 5.31 The Board accepts for now that the changes in the Ontario corporate tax rates are or will be reflected in the GDPPI, and that no Z factor adjustment should be made at this time with respect to the rate schedules currently in effect under the PBR plan. The income tax changes, therefore, are to be considered to be captured in the determination of the PCI.
  
- 5.32 In respect of the second issue relate to taxes, the Board notes that the Applicant has not implemented the Board's direction to decrease its base revenue by \$900,000 to reflect the adjustment of corporate income tax which took effect in May 2000 and which is necessary to determine an appropriate base from which to go forward. That direction appeared in paragraph 2.169 of the RP-1999-0017 Decision with Reasons.
  
- 5.33 An adjustment of this type is necessary in order to make the base in 2000 "normal" for the future period when rates will be in effect. Union has suggested that because the Board asked it to track changes in corporate income taxes for presentation and consideration by the Board in its future assessment of the acuity of the GDPPI in capturing tax changes, it decided to delay or forego the implementation of the Board's direction.

3

**Ontario Energy  
Board**

**Commission de l'Énergie  
de l'Ontario**



**RP-2004-0188**

**2006 ELECTRICITY DISTRIBUTION RATE  
HANDBOOK**

**REPORT OF THE BOARD**

**2005 MAY 11**

tax information disclosure, addressed later in this section, will allow for adequate monitoring of these issues.

With respect to the third point, the Board accepts the evidence of Dr. Mintz that in a competitive market tax reductions will tend to lead to lower prices, but does not agree with his conclusion that the tax savings of disallowed expenses should be passed on to ratepayers. Such an approach takes no account of the increased expenditures from which the tax savings arise. Presumably in a competitive market, if an entity incurs a cost from which a tax reduction is gained, the increased cost works its way into prices as well. A unilateral allocation of the tax savings to the ratepayers would seem to be an inappropriately simplistic application of the competitive market principle.

With respect to the fourth point, the Board does not agree that the link between PILs and the stranded debt is relevant. All tax revenues are used for some purpose, whether to fund programs or repay debt. To the extent tax deductions are allowed, there will necessarily be a reduction in funds available for those other purposes. The relationship between PILs and the stranded debt is no different. This conclusion is supported by the fact that the express purpose of PILs was to put municipal distributors on an equivalent basis with tax paying distributors. The fact that PILs payments are allocated to the stranded debt is a function of provincial policy and is not necessarily a permanent feature. Finally, the Board notes that PILs from distributors are not the only, or largest, source of funds currently paying down the stranded debt.

For all of these reasons, the Board rejects the proposal by Schools, and concludes that tax savings arising from disallowed expenses, including purchased goodwill and charitable donations, will not be allocated to ratepayers. Ratepayers have not paid for the expense through rates, and therefore are not entitled to the tax benefit.

#### **Fair market value “bump”**

The Ministry of Finance required the re-valuation of distributor assets to market value, effective October 1, 2001. This Fair Market Value Bump, or FMV Bump, adjusted the

5

3. L/T2.

## 2 INFLATION FACTOR

2.1 **WHAT TYPE OF INDEX SHOULD BE USED AS THE INFLATION FACTOR (INDUSTRY SPECIFIC INDEX OR MACROECONOMIC INDEX)?**

2.1.1 **Which macroeconomic or industry specific index should be used?**

(Complete Settlement)

The parties agree that the inflation factor to be used in Union's price cap index is the actual year over year change in the annualized average of 4 quarters (using Q2 to Q2) of Statistics Canada's Gross Domestic Product Implicit Price Index Final Domestic Demand (GDP IPI FDD). For 2008, the inflation factor calculated in this manner is 2.04%. The inflation factor will be adjusted annually on this basis, as set forth under Issue 12.1 below, with no true ups.

The following parties agree with the settlement of this issue: APPrO, BOMA, CCC, EGD, Energy Probe, IGUA, Jason Stacey, Kitchener, LPMA, OAPPA, SEC, Sithe, Timmins, TransAlta, Union, VECC, WGSPG.

The following parties take no position on this issue: Coral, GEC, PP, PWU, TCPL.

Evidence References:

1. B/T1 p.21-22, D/T1/App A.
2. C32.7.
3. L/T1/S2, L/T4/S1.

**5.2 WHAT ARE THE CRITERIA FOR DISPOSITION?**

(Complete Settlement)

See 5.1 above.

Evidence References:

1. C3.20, C3.21, C11.04.

**6 Z FACTOR**

**6.1 WHAT ARE THE CRITERIA FOR ESTABLISHING Z FACTORS THAT SHOULD BE INCLUDED IN THE IR PLAN?**

(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; Complete Settlement on all other aspects of the issue.)

The parties agree that Z factors generally, have to meet the criteria established in Union's evidence, i.e.,

1. the event must be causally related to an increase/decrease in cost;
2. the cost must be beyond 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).

If a proceeding is instituted before the Board, before the term of this IR plan expires, in which changes to the methodology for determining return on equity is requested, then all parties