



By E-mail

July 6, 2007

Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
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Toronto, ON M4P 1E4

Dear Ms Walli

Union Gas Limited ("Union")
Application for 2006 Deferral Account and Earnings Sharing Disposition
Board File No.: EB-2007-0598
Our File No.: 302701-000416

This letter is being written on behalf of the following intervenors representing ratepayer interests: Consumers Council of Canada ("CCC"), Vulnerable Energy Consumers Coalition ("VECC"), School Energy Coalition ("SEC"), London Property Management Association ("LPMA") and the Industrial Gas Users Association ("IGUA").

These ratepayer representatives have been collaborating in an attempt to identify the various issues which the "Deferred Taxes" feature of Union's Deferral Account Clearing Application raises.

The purpose of this letter is to provide Union and the Board with advance notice of these matters, including the position that one or more of the ratepayer representatives will likely take with respect to these issues at the oral hearing of this matter scheduled to commence on Monday, July 9, 2007.

Although there have been very high level and informal consultations with a Chartered Accountant ("CA") who is also a regulatory consultant with respect to the Deferred Taxes feature of Union's Application, there are a number of constraints, including the limited time between July 5, 2007, when Union responded to outstanding Interrogatories pertaining to the Deferred Taxes issue and the hearing commencement date of Monday, July 9, 2007, for the ratepayer representatives to fully brief and obtain opinion evidence from an expert witness of their choosing.

Accordingly, the evidence upon which the ratepayer representatives will rely at the hearing commencing July 9, 2007, will include Union's Pre-Filed Evidence, the

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responses to Interrogatories thereon, and the cross-examination of Union's witnesses at the hearing, including witnesses from KPMG/Deloittes. Some additional materials to which ratepayer representatives may refer in their cross-examination of the witnesses and in argument include the following:

- (a) Documents with respect to Union's 2006 Rates;
- (b) Union's formal Rate Order with respect to its 2007 Rates and excerpts from the Schedules thereto;
- (c) Excerpts from the Board's NGEIR Decision dated November 7, 2006;
- (d) Excerpts from EBO-179-14/15;
- (e) Excerpts from RP-2002-0135;
- (f) Excerpts from RP-2003-0203, and
- (g) Excerpts from Union's 1998 Annual Report.

We are attempting to provide electronic copies of these materials to Union and others before the close of business today. If we are unable to do this, then we expect to provide electronic copies of the materials by Sunday, July 8, 2007.

The ratepayer representatives are of the view that the issues which are raised by the Deferred Taxes feature of Union's Application fall to the following three (3) categories:

1. Whether there is any basis on which the Deferred Tax liability, which Union attributes to the Board's NGEIR Decision with Reasons dated November 7, 2006, can be charged to Union's 2006 S&T Long Term Storage Premium Deferral Account - Account No. 179-72; (emphasis added)
2. Whether there is any basis upon which a Deferred Tax liability attributable to the Board's new "Non-Utility" classification of Union's sales of storage services to ex-franchise customers can ever be recoverable from ratepayers who continue to use regulated services provided by Union; and
3. If there is any basis for those ratepayers who continue to pay regulated rates for the monopoly services Union provides to be called upon, in future years, to pay taxes associated with Union's provision of storage services to ex-franchise customers, then what is the appropriate regulatory treatment for determining the amount payable and the future year or years in which the payments should be made.

Within each of these questions, there are a number of subsidiary issues to be considered. It should be noted, however, that the extent to which the Board will need to consider

subsidiary issues with respect to items 2 and 3 above at the hearing on Monday, July 9, 2007, will depend upon its response to matters falling within the ambit of issue 1.

If there is no basis for charging any portion of the Deferred Tax liability to Union's 2006 S&T Revenue Deferral Account, then matters falling within the ambit of issues 2 and 3 above can be dealt with by the Board in a later Union proceeding. On the other hand, if there is a finding that something is chargeable against the 2006 S&T Revenue Deferral Account No. 179-72, then the Board will need to consider matters falling within the ambit of item 3 above before determining how much is chargeable.

Within the ambit of the issue described in 1 above, it will be the position of ratepayer representatives that Deferred Taxes associated with the Board's re-classification of Union's ex-franchise storage services sales as "non-utility" transactions effective January 1, 2007, cannot be charged against Union's 2006 S&T Revenue Deferral Account No. 179-72 for any one of the following reasons:

- (i) All of the storage services Union provided during 2006 to and including December 31, 2006, where rate regulated. Union was a rate regulated enterprise throughout calendar year 2006. Accordingly, for regulatory purposes, there is no factual base for treating Union as anything other than a rate regulated enterprise to and including December 31, 2006;
- (ii) If there is a Deferred Tax liability associated with Union's sales of storage services to ex-franchise customers which must be recorded because of the NGEIR Decision with Reasons, the liability arises after January 1, 2007, which is the earliest date on which the NGEIR Decision became effective for Union;
- (iii) At this point in time, the Deferred Taxes which Union has recorded in its Financial Statements are simply a future liability. They are not an expense incurred by Union in 2006 within the parameters of the Board's 2006 Rate Order for Union, including its provisions pertaining to the S&T Revenue Deferral Account No. 179-72 attached as part of the Schedules thereto.

Within the ambit of issue 2 above, it will likely be the position of ratepayer representatives that the re-classification of ex-franchise sales services from utility to "non-utility" operates prospectively and not retroactively, with the result that the tax liability impact of the re-classification is itself classified as "non-utility" and confined to having an impact on the net income that the ex-franchise storage services business line produces for Union's owner. All tax liabilities associated with the "non-utility" re-classification are "non-utility" liabilities.

Ratepayer representatives will probably rely on one or more of the following facts to support the conclusion that tax liabilities associated with the "non-utility" re-classification of ex-franchise storage services are "non-utility" liabilities:

- (i) Union's 1997 transfer to its affiliate of the unrecorded Deferred Tax liability associated with its rental program business without any adverse rate impact on its utility ratepayers;
- (ii) Union's failure to raise the Deferred Taxes consequences of its forbearance proposals with respect to ex-franchise storage services transactions in either the NGEIR proceeding or in its 2007 Rate Case in which Union identified a number of matters which would be affected by the Board's NGEIR Decision; and
- (iii) The "end state" level of profits Union's shareholder will realize from the unregulated sale of ex-franchise storage services, which will be more than adequate to absorb the Deferred Tax liability created by the Board's re-classification of this business activity as "non-utility".

With respect to the ambit of issue 3 above, if users of monopoly services provided by Union are exposed to the Deferred Tax liability associated with its sales of storage services to ex-franchise customers, then the timing of recovery and the amount thereof will need to be determined having regard to the following:

- (i) Whether the amount recoverable should only be charged to ratepayers on a yearly basis in the years following cross-over, or whether an attempt is going to be made now to estimate the present value of the ratepayers' net exposure, if any, to ex-franchise storage-related Deferred Taxes;
- (ii) If a present value estimate of the ratepayers net exposure is to be attempted, then the items that will need to be considered include the following:
 - (1) The rate base deduction and the resulting revenue requirement reductions that are likely to prevail during the period that any accumulated ex-franchise storage-related Deferred Taxes remain undrawn;
 - (2) The anticipated cross-over date for the drawdown of Deferred Tax balances associated with Union's "non-utility" sales of storage services to ex-franchise customers effective January 1, 2007;
 - (3) The estimated income tax rates that are likely to prevail when the Deferred Tax balances are drawn down;
 - (4) The significance of the 100 PJ cap in a determination of the ex-franchise storage-related Deferred Tax liability estimate and the implications of a Board Decision eliminating the cap; and
- (iii) Whether the extent of the ratepayers' exposure to any ex-franchise storage-related Deferred Tax liability is only attributable to the Long Term



Storage Premium Revenue Deferral Account, the ratepayers' share of which is scheduled to terminate as of 2011.

As already noted, the extent to which the Board will need to consider these issues will depend upon the Board's findings with respect to the question of whether there is any factual basis for charging any portion of the Deferred Tax liability to Union's 2006 S&T Revenue Deferral Account No. 179-72.

In addition, it is probably premature to consider matters pertaining to how much, if any, ex-franchise storage-related Deferred Tax liability is recoverable from ratepayers before all matters pertaining to requests for review of the NGEIR Decision have been finally determined.

We hope that this letter assists the Board and Union in preparing for the hearing scheduled to commence on Monday, July 9, 2007.

Yours very truly

A handwritten signature in black ink, appearing to read 'Peter C.P. Thompson', is written over a horizontal line.

Peter C.P. Thompson, Q.C.

PCT\slc

c. Interested Parties EB-2007-0598
Murray Newton (Industrial Gas Users Association)
Vince DeRose (Borden Ladner Gervais LLP)

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