

ONTARIO ENERGY BOARD

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.

AND IN THE MATTER OF a Motion for Review and Variance brought by the Applicant, Union Gas Ltd.

**SUBMISSIONS OF THE
SCHOOL ENERGY COALITION**

November 6, 2008

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INTRODUCTION

1. These are the submissions of the School Energy Coalition ("SEC") in response to the Notice of Motion and Pre-Filed Evidence of Union Gas Limited ("Union"). Union has brought a motion seeking review and variance of the Board's Decision and Order (the "Tax Decision") dated July 31, 2008.

Tax Change Pass Through

2. Union is seeking a clarification of the Board's Decision regarding the impact of tax rate changes on its distribution rates. Specifically, Union asks the Board to order that tax changes should not be applied in the manner set out in Exhibit E3.1.1.

3. The Tax Decision dealt with the extent to which changes in tax rates should flow through to ratepayers through the price cap formula. Union argued, ostensibly, that they should not, since the impact of tax rate changes flowed through the economy through the inflation rate and are therefore already included in the price cap formula. The Board rejected Union's position and found that only a portion of the tax rate changes will be reflected in the inflation rate during the incentive regulation period.

4. Now, Union tries a new attack against passing tax rate changes on to ratepayers. Union argues that the Exhibit [E3.1.1] the Board referred to in its decision overstates the tax savings to be passed on to ratepayers because they include "asset additions beyond 2007." The underlying rationale for Union's position is stated in its Notice of Motion:

During the term of the incentive regulation plan, however, Union will not be making any additions to rate base for rate setting purposes and will, therefore, be recovering nothing in rates for the incremental cost of capital and taxes associated with new capital additions in the years 2008 to 2012.

Since Union will be recovering nothing in rates related to new capital additions during the incentive regulation plan, it would be unfair and asymmetrical for Union to be required to credit to

customers 50% of any tax reductions associated with those new additions.

[Union Notice of Motion, para. 16-17.]

Nature of Price Cap Regulation

5. Union's position in this motion fundamentally mischaracterizes the essence of incentive regulation, and price cap regulation in particular.

6. The issue is not, as Union has put, whether it will be updating its rate base during the incentive regulation period. Rather, the issue is the extent to which the cost of capital additions have been taken into account in the price cap formula.

7. Union now argues that the calculation of tax savings in Exhibit E3.1.1 is incorrect because it will not be recovering anything in rates for "incremental cost of capital and taxes associated with new capital additions" during the incentive regulation period. In SEC's submission, Union's position incorrectly links a cost of service construct, rate base, with a price cap formula. The fact that its rate base will not be updated during the incentive regulation period does not mean that Union is not being compensated for capital additions during that period.

8. In fact, a fundamental component of price cap regulation is that the index is based on expected increases to the utility's input costs, which includes assumed changes in capital assets.

9. During the proceedings regarding the 3rd Generation Incentive Regulation framework for electricity distributors, the Board took as a given that the index "reflects a historical pattern of capital expenditure for the industry, and that generally a separate capital module should not be required under a comprehensive rate indexing plan." [Ontario Energy Board, *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, July 14, 2008, p. 24-25]

10. SEC submits, therefore, that is indisputable that a price cap formula includes compensation for a normal level of capital additions.

11. What a price cap formula does not do, however, is develop a precise level of capital additions for each year. The question the Board panel had to address in the Tax Decision, therefore, was the specific amount of capital additions that should be assumed for the purpose of calculating the impact of tax changes on Union's rates. It was in this context that, SEC submits, the Board issued its directive in the Tax Decision that that determination would be made in accordance with Exhibit E3.1.1.

12. SEC submits that the Board's direction in the Tax Decision was unambiguous: it provided a clear direction to Union as to how the tax savings were to be calculated.

13. If, as Union now argues, the capital expenditures assumed for the purpose of calculating the tax savings are inflated, then that means the price index itself is inflated, since it is based on the same level of capital expenditures. In SEC's submission, Union cannot have it both ways: it cannot have a price index based on an "inflated" level of capital expenditures *and* a tax decision based on some arbitrarily determined lower number.

Costs

14. SEC participated responsibly in this proceeding and sought to contribute to the Board's understanding of the issues. SEC therefore respectfully requests that it be awarded 100% of its reasonably incurred costs.

All of which is respectfully submitted this 6th day of November, 2008:

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Counsel to the School Energy Coalition