

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.

CME'S COMPENDIUM OF DOCUMENTS

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UNION GAS LIMITED

Answer to Interrogatory from
The Building Owners and Managers Association of the Greater Toronto Area ("BOMA")
The London Property Management Association ("LPMA")
The Wholesale Gas Service Purchasers Group ("WGSPG")

Question:

Please provide a schedule, similar to that in the Enbridge Gas Distribution Settlement Agreement dated February 4, 2008 (Exhibit N1, Tab 1, Schedule 1, Appendix D, Page 52 of 6 – see attached), excluding lines 22, 33, 42, 44, 45 and 46 that are related to the 50% sharing. Please reflect the appropriate EB-2005-0520 Board Decision figures in this table.

Response:

Please see Attachment.

Question: February 15 2008
Answer: February 22, 2008
Docket: EB-2007-0606

Estimated Tax Rate Change Impacts (2008-2012)

Line No.	Tax Related Amounts Forecast from CCA Rate Changes	(\$ millions)	2008 (a)	2009 (b)	2010 (c)	2011 (d)	2012 (e)	
1	Computer Equipment (Class 45) - Opening UCC Balance		6.77	10.50	12.55	13.68	14.30	
2	New purchases (2007 Board Approved additions)		8.74	8.74	8.74	8.74	8.74	
3	Capital cost Allowance (CCA) at 45% - former tax rule CCA rate		5.02	6.69	7.61	8.12	8.40	
4	Closing Undepreciated Capital Cost (UCC)		10.50	12.55	13.68	14.30	14.64	
5	Computer Equipment (Class 45) - Opening UCC Balance		6.34	9.19	10.47	11.05	11.31	
6	New purchases (2007 Board Approved additions)		8.74	8.74	8.74	8.74	8.74	
7	Capital cost Allowance (CCA) at 55% - 2007 Federal Budget tax rule CCA rate		5.89	7.46	8.16	8.48	8.62	
8	Closing Undepreciated Capital Cost (UCC)		9.19	10.47	11.05	11.31	11.43	
9	Distribution Assets (Class 1) - Opening UCC Balance		130.56	255.90	376.23	491.74	602.64	
10	New purchases (2007 Board Approved additions)		133.23	133.23	133.23	133.23	133.23	
11	Capital cost Allowance (CCA) at 4% - former tax rule CCA rate		7.89	12.90	17.71	22.33	26.77	
12	Closing Undepreciated Capital Cost (UCC)		255.90	376.23	491.74	602.64	709.09	
13	Distribution Assets (Class 1) - Opening UCC Balance		129.23	250.71	364.89	472.23	573.13	
14	New purchases (2007 Board Approved additions)		133.23	133.23	133.23	133.23	133.23	
15	Capital cost Allowance (CCA) at 6% - 2007 Federal Budget tax rule CCA rate		11.75	19.04	25.89	32.33	38.38	
16	Closing Undepreciated Capital Cost (UCC)		250.71	364.89	472.23	573.13	667.97	
17	CCA Difference		4.74	6.90	8.73	10.36	11.84	
18	Tax Rate (Anticipated Corporate Income Tax Rates during IR term)		33.50%	33.00%	32.00%	30.50%	29.00%	
19	Tax Impact		1.59	2.28	2.79	3.16	3.43	
20	Grossed-up Tax Amount (Cumulative Total Forecast)		2.39	3.40	4.11	4.54	4.84	19.27
21	Incremental Amount		2.39	1.01	0.71	0.44	0.29	

Tax Related Amounts Forecast from Income Tax Rate Changes

22	Taxable Income (Rate Order Working Papers/S4/col (e)/line 10)		80.782	80.782	80.782	80.782	80.782	
23	Gross Deficiency (Rate Order Working Papers/S1/col (e)/line 7)		23.12	23.12	23.12	23.12	23.12	
24	Interest Income (included in Taxable Income, line 23)		-	-	-	-	-	
25	Board Approved Taxable Income for Income Tax Expense Calculation		103.9	103.9	103.9	103.9	103.9	
26	2007 Approved Tax Rate		36.12%	36.12%	36.12%	36.12%	36.12%	
27	Anticipated Tax Rates During the IR Term		33.50%	33.00%	32.00%	30.50%	29.00%	
28	Tax Rate Variance		2.62%	3.12%	4.12%	5.62%	7.12%	
29	Annual Income Tax Savings vs. 2007 Approved Taxes (Cumulative Total Forecast)		2.72	3.24	4.28	5.84	7.40	
30	Grossed-up Tax Savings		4.09	4.84	6.30	8.40	10.42	34.05
31	Incremental Amount		4.09	0.74	1.46	2.11	2.02	

Tax Related Amounts Forecast from Capital Tax Rate Changes

32	2007 Taxable Capital as Filed (EB-2005-0520, Exhibit D3/T5/S1)		3,020.9	3,020.9	3,020.9	3,020.9	3,020.9	
33	2007 Decision and Settlement Agreement Adjustments to Taxable Capital		-	-	-	-	-	
34	2007 Board Approved Taxable Capital		3,020.9	3,020.9	3,020.9	3,020.9	3,020.9	
35	2007 Board Approved Capital Tax Rate (EB-2005-0520 ADR Agreement, p.20)		0.285%	0.285%	0.285%	0.285%	0.285%	
36	Anticipated Capital Tax Rates During the IR Term (1)		0.225%	0.225%	0.075%	0.000%	0.000%	
37	Capital Tax Variance		0.060%	0.060%	0.210%	0.285%	0.285%	
38	Annual Capital Tax Savings vs. 2007 Approved Taxes (Cumulative Total Forecast)		1.81	1.81	6.34	8.61	8.61	27.19
39	Incremental Amount		1.81	-	4.53	2.27	-	
40	Cumulative Total Forecast Tax Related Amount (lines 20+30+38)		8.29	10.05	16.75	21.56	23.86	80.51

Note:

(1) The capital tax rate used in EB-2007-0615, Exhibit N1, Tab 1, Schedule 1, Appendix D was 0.150%. Effective January 1, 2010 the Ontario capital tax rate is set at 0.150% and effective July 1, 2010 the Ontario capital tax is scheduled to be eliminated completely. As stated in the government's documents that accompanied its Economic Statement in December, these reductions are to be pro-rated for taxation years straddling the effective dates. Since Union Gas has a December 31st year end, the Company's capital tax rate for 2010 will be $(0.150\% + 0.0\%) \times 0.5 = 0.075\%$.

1 MR. KAISER: Yes. Thank you.

2 MR. PENNY: And that, Mr. Chairman, the issues are
3 reasonably well-defined in the evidence, and we have given
4 our response to the intervenors in our reply evidence.

5 So with that, I will turn the matter over to my
6 friends and make the witnesses available.

7 Oh, sorry. I left out the one technical thing I am
8 supposed to do, which is that you, gentlemen, are the
9 authors of prefiled evidence on the relationship of
10 business tax policy to the inflation factor in this case;
11 is that correct?

12 DR. MINTZ: That is correct.

13 DR. WILSON: Correct.

14 MR. PENNY: You are also -- and Mr. Birmingham, some
15 of the information that was made available, some of the
16 prefiled information, and some of the information made
17 available to Messrs. Mintz and Wilson was provided by Union
18 Gas?

19 MR. BIRMINGHAM: That's correct.

20 MR. PENNY: And collectively, there are answers to
21 interrogatories, some of which were answered, I take it, by
22 Messrs. Mintz and Wilson, some by Union. But do you adopt
23 all of that evidence for the purposes of this hearing?

24 DR. WILSON: Yes.

25 DR. MINTZ: Yes.

26 MR. BIRMINGHAM: Yes.

27 MR. PENNY: Thank you. Sorry, Mr. Chairman, I left
28 out that step.

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1 the economy, that will, over time, be reflected in the GDP,
2 but we're going to reflect it directly in our costs,
3 because we have engineers in our employee population and we
4 would reflect the wages for those people.

5 So it's just -- it's a different mechanism, but it
6 still shows the impact on Union of those inflationary
7 pressures.

8 MR. SHEPHERD: Well, you're not going to go get a
9 macroeconomic indicator to determine if wages are going to
10 go up.

11 MR. BIRMINGHAM: That's not what I'm saying.

12 MR. SHEPHERD: You're going to look at your Union
13 contracts and you're going to look at your -- at what
14 you've already agreed with people that their wage increase
15 is going to be for next year; isn't that right?

16 MR. BIRMINGHAM: That's correct.

17 MR. SHEPHERD: You're going to do a budget based on
18 what you think is going to happen, not based on what the
19 economy is doing?

20 MR. BIRMINGHAM: No. But those two things are linked,
21 Mr. Shepherd; that's my only point.

22 MR. SHEPHERD: Okay. I am looking at Exhibit 3.3.1.
23 This is the -- we have alluded to this in its absence a
24 number of times. The attachment is your calculation of the
25 tax changes, the impacts; right?

26 MR. BIRMINGHAM: It is our calculation based on the
27 assumptions that were given to us, yes.

28 MR. SHEPHERD: Well, so one of the things you did -- I

1 just want to clarify some stuff in here.

2 One of the things you did, if you take a look at line
3 9 and line 13, and indeed I think the same is true in lines
4 1 and 5, you're assuming that your carry-over balance for
5 your undepreciated capital cost is different based on
6 whether you're calculating the tax savings or not; right?
7 There's a rationale for that. I am going to ask you for
8 your rationale.

9 MR. BIRMINGHAM: Right.

10 MR. SHEPHERD: Your rationale is?

11 MR. BIRMINGHAM: Well, I'll go back and check, Mr.
12 Shepherd, but I believe that all we've done is calculated
13 the fact that there's some additional CCA that's available
14 on the opening balance, which would be 2007. So there's a
15 small difference in the UCC balances, because you get some
16 of that UCC applied to the 2007 additions.

17 MR. SHEPHERD: In fact, what that does, then, is it
18 reduces the impact of the tax savings during this period,
19 during the five-year period, by an impact of the 2007
20 change; right?

21 MR. BIRMINGHAM: Because you're picking up some of the
22 2007 change, that's correct.

23 MR. SHEPHERD: Okay. Do you know what the total is
24 when you carry that all the way through?

25 MR. BIRMINGHAM: No, I don't, but you can calculate it
26 from the numbers that are here.

27 MR. SHEPHERD: It's \$2- or \$3 million; right,
28 something like that? It is not huge.

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1 MR. BIRMINGHAM: You are talking about just the
2 difference in the opening balance as it moves forward?

3 MR. SHEPHERD: Yes.

4 MR. BIRMINGHAM: I will take that subject to check.

5 MR. PENNY: So, sorry, just for my benefit, which
6 opening balance are we referring to now? Because you
7 referred to a number of different lines, which I thought
8 included computer equipment and distribution assets.

9 MR. SHEPHERD: They do.

10 MR. PENNY: So which --

11 MR. SHEPHERD: So lines 1 and 5, which are supposed to
12 be the same, are different. And lines 9 and 13, which
13 would normally be the same, are different. They're the
14 same class. They started with a different opening balance.
15 That changes your result; right?

16 MR. BIRMINGHAM: Well, it changes your result because
17 you take some of the higher CCA on your 2007 additions.
18 That's why it's a different opening balance for 2008.

19 MR. SHEPHERD: Then the second part of it is that line
20 32, you haven't assumed increases in rate base, even though
21 you know there are going to be increases in rate base;
22 right?

23 MR. BIRMINGHAM: We haven't assumed any increases in
24 the taxable capital; that's right.

25 MR. SHEPHERD: Which would move at roughly the same
26 rate as rate base; right?

27 MR. BIRMINGHAM: It's a different calculation, but
28 there would be increases to the extent that there were

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1 capital additions.

2 MR. SHEPHERD: Okay. And you haven't assumed that --
3 was that one of the assumptions?

4 MR. BIRMINGHAM: That's correct. This is the
5 methodology that was used in the context of the Enbridge
6 settlement, and we were asked to reflect that same
7 calculation in this schedule.

8 MR. SHEPHERD: Exactly. So if the taxable capital
9 went up, then your impacts would go up, too; right?

10 MR. BIRMINGHAM: That's true of all of the changes,
11 CCA, income tax and capital tax, that if they're higher or
12 lower on an actual basis, the results will be different.

13 MR. SHEPHERD: And you don't anticipate that your
14 taxable capital is going to stay the same for those five
15 years?

16 MR. BIRMINGHAM: It would only be by pure coincidence
17 that these numbers were the same for that five-year period.

18 MR. SHEPHERD: You, in fact, expect your taxable
19 capital to increase over the next five years; correct?

20 MR. BIRMINGHAM: Typically, to the extent that our
21 capital additions are more than our depreciation in a given
22 year, yes.

23 MR. SHEPHERD: Similarly, if you look at line 22, this
24 is your taxable income, and I'm not going to go through all
25 of the reasons why your taxable income changes. I
26 understand it's very complicated, almost as complicated as
27 this economics stuff. But you don't expect your taxable
28 income to stay the same for five years, either, do you?

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1 MR. BIRMINGHAM: No. It could be higher or lower
2 depending on the dynamics in our business, including
3 weather impacts.

4 MR. SHEPHERD: But your expectation would be that, in
5 the normal course, your natural growth would -- and the
6 increase in your rate base would mean that you would end up
7 with a higher income over time; right?

8 MR. BIRMINGHAM: I would hope so. The difficulty I'm
9 having, Mr. Shepherd, is really with respect to taxable
10 income. So as an example, if you invest in storage assets,
11 that has a much higher CCA rate than some of our other
12 ones. So the taxable income can move around, but,
13 generally speaking, we would expect to hopefully see an
14 upward trend.

15 MR. SHEPHERD: All of these things we're talking about
16 will have a tendency, then, to understate this \$80.5
17 million; right? That \$80.5 million is sort of a minimal
18 number and it could be significantly higher than that;
19 fair?

20 MR. BIRMINGHAM: Not necessarily.

21 I would agree generally that that is probably the
22 direction for the income tax rate changes and for the
23 capital tax rate changes. With respect to the CCA, it's
24 really going to depend on the level of capital budget
25 expenditures relative to the 2007 Board-approved. So that
26 may be higher or lower.

27 MR. SHEPHERD: Well, except your evidence in the rate
28 case, in this particular rate case that we're still in --

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1 still in -- is that the primary thing you want to do is
2 build distribution equipment, because in the long term
3 that's how you get revenue. Isn't that your evidence?

4 MR. BIRMINGHAM: We want to grow our asset base,
5 that's absolutely true. That depends on a number of
6 things, including customer demand.

7 MR. SHEPHERD: Of course.

8 So have you done this calculation using more sort of
9 realistic assumptions?

10 I don't mean that in a pejorative way. I mean that in
11 the sense of, you know, what you actually expect is likely
12 to happen.

13 MR. BIRMINGHAM: We don't have a five-year forecast,
14 so we haven't redone this calculation. We have done it
15 simply on the basis that the Enbridge calculation had been
16 done.

17 MR. SHEPHERD: Okay. Another thing I want to ask you
18 about in this is you have -- the tax rate changes and the
19 tax and the CCA changes are interactive; right? One will
20 affect the other; true?

21 MR. BIRMINGHAM: That's correct.

22 MR. SHEPHERD: So what you have assumed in this -- I'm
23 not saying it is your fault. This is the model. You were
24 asked to do a particular calculation using a particular
25 model, which happens to have this built in.

26 But what this model does is it assumes that the --
27 that the rate changes are the important ones and that the
28 CCA changes are reduced by the rate changes; right?

1 MR. BIRMINGHAM: I'm not sure I understand your
2 question, Mr. Shepherd.

3 The way we have calculated this in this particular
4 sheet is that the CCA changes aren't reflecting in our
5 taxable income. So that's why we've taken the CCA change
6 at the new tax rate, and then we've kept our taxable income
7 whole, without reducing it further for the increased CCA
8 deductions, and taken the difference in the tax rate.

9 So we've calculated so that the impacts are
10 independent, that is, they would be additive as opposed to
11 any overlapping or double-counting.

12 MR. SHEPHERD: I understand that. So you tried to be
13 neutral with respect to the rate. I get that. But the --

14 MR. BIRMINGHAM: It's not neutral. Just trying to
15 isolate the impacts so there isn't double-counting or
16 anything missed.

17 MR. SHEPHERD: Fair enough.

18 But it's true, isn't it, that the actual impact of the
19 CCA differential, if you look at that in isolation, you
20 would have to assume that the tax rate remains constant,
21 and that the effect of a lower CCA benefit is because of
22 the tax rate going down? Isn't that right? In fact,
23 didn't you do this calculation for Mr. Aiken in one of his
24 interrogatories?

25 MR. BIRMINGHAM: We did respond to an interrogatory
26 from Mr. Aiken, but that was on the basis of anticipated
27 tax rate changes that were a little bit higher than these
28 ones, and we had some announced tax changes between the

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1 time that we filed that response and this one.

2 So this is the most up-to-date information.

3 MR. SHEPHERD: Just bear with me for one second.

4 Now, what I am looking at is E3.1.7, the attachment.
5 What Mr. Aiken asked you is -- if we just look at the CCA
6 impact in isolation, which means we don't reduce it for the
7 fact that there's also tax rate changes, we just look at it
8 in isolation, we control for everything else, in effect;
9 right? Then you have calculated the effect as \$24 million
10 rather than the 19 that you had before; right?

11 MR. BIRMINGHAM: That's correct.

12 MR. SHEPHERD: And in fact, if you were to carry that
13 through -- this is only part of the chart -- but if you
14 were to carry that through, in order to be neutral, you
15 would have to, then, reduce the tax rate impact by that
16 amount.

17 MR. BIRMINGHAM: You would have to reduce your taxable
18 income on line 22 by the amount of the CCA, so that when
19 you calculated that difference, you weren't double-
20 counting. So --

21 MR. SHEPHERD: Yes.

22 MR. BIRMINGHAM: The impact would be, you would move
23 roughly \$5 million, that is the difference between the
24 24.07 on Exhibit E3.1.7, compared to the 19.27. So you
25 move \$5 million up to the CCA line, but you reduce it by a
26 corresponding amount the 34.05 million, which is the income
27 tax rate interest.

28 MR. SHEPHERD: Exactly. Okay, thank you. That clears

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1 that up very nicely. Now, the last thing I wanted to look
2 at in 3.1.1 is the impact you calculated for 2008, total
3 impact is \$8.3 million; right?

4 MR. BIRMINGHAM: That's line 40, column A, yes.

5 MR. SHEPHERD: Yes. Subject to all of these other
6 things we've talked about, which may make that slightly
7 different depending on what assumptions you make, 8.3 is
8 roughly what you think is what you're going to save in
9 taxes this year.

10 MR. BIRMINGHAM: On the basis of these assumptions,
11 yes.

12 MR. SHEPHERD: Now, that carries through for five
13 years, right? You're going to save that every year,
14 because the taxes aren't going down just for one year.
15 They're going down permanently, right?

16 MR. BIRMINGHAM: Right. This is the annual impact,
17 but to the extent those rates continue to decline, or even
18 just have this decline and then carry on, that's correct.

19 MR. SHEPHERD: So if there were no further reductions,
20 I calculate that you would actually have about a \$42
21 million saving just from the change in 2008. Is that
22 right? Am I in the right ballpark?

23 MR. BIRMINGHAM: If you look at 8.3 times five, you're
24 roughly in the \$41 million --

25 MR. SHEPHERD: Here's what I don't understand. I
26 understand that you might think that along the way, over
27 five years, there are some GDP impacts that are going to
28 offset things, et cetera, et cetera.

1 But we know what your rates are going to be this year.
2 And we know how much tax you're going to save. And your
3 rates are not going to be lower by \$8.3 million because of
4 the tax saving. So isn't that a windfall of \$42 million?
5 Tell me why that is not true.

6 MR. BIRMINGHAM: I think for the same reason we have
7 been talking about most of the day, that over time, those
8 will get reflected in the GDP IPPI FDD, and you will see
9 price decreases caused, in isolation, by these income tax
10 rate changes.

11 MR. KAISER: Would you agree it is not going to happen
12 in year 1?

13 MR. BIRMINGHAM: Yes, sir.

14 MR. SHEPHERD: Mr. Chairman, thank you for your
15 patience. Those are my questions.

16 MR. KAISER: Thank you. Who is next?

17 MR. SHEPHERD: Mr. Chairman, since nobody else is
18 speaking up, I will speak up.

19 Some of my friends, they didn't have the opportunity
20 to know what areas I would cover today. I know that their
21 crosses are very short. They can speak for themselves.
22 But I wonder if it makes sense to break today, and come
23 back tomorrow morning when they can shorten their cross?

24 MR. KAISER: That's fine with us. Does that suit you,
25 gentlemen? Perhaps you want to proceed, Mr. Thompson, and
26 get back to Ottawa?

27 MR. THOMPSON: No, thanks. I'm enjoying this so much
28 I'm going to stay here.

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1 [Laughter]

2 MR. THOMPSON: Thanks very much though. Thanks for
3 the offer.

4 MR. KAISER: All right. 9:30 tomorrow.

5 ---Whereupon the hearing adjourned at 4:10 p.m.

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1 Because we would actually -- if the Board is to make a
2 finding that the 2007 rates should be adjusted with respect
3 to the changes in capital tax and CCA rates, then that is
4 the total of \$2.8 million that's reflected in Exhibit
5 E3.1.4.

6 MR. THOMPSON: Okay. If it is only the capital tax
7 and CCA, then it's the \$46 million?

8 MR. BIRMINGHAM: No. If it's only capital tax and CCA
9 for the period 2008 to 2012, then that's the \$46 million.

10 MR. THOMPSON: But if they make that finding for 2007,
11 does it not automatically flow through?

12 MR. BIRMINGHAM: It would be higher by the \$2.8
13 million that is included for 2007.

Z-FACTOR STATUS

14 MR. THOMPSON: Thank you. Let's move on to the Z-
15 factor status of tax reductions, 2008 to 2012.

16 Just a couple of points: The amount in issue is this
17 \$80.5 million that's referenced in Exhibit 3.1.1. It could
18 be more under different assumptions. Is that what I should
19 take from your discussion with Mr. Shepherd yesterday?

20 MR. BIRMINGHAM: It could be more or less, depending
21 on the actual amounts that materialize, yes.

22 MR. THOMPSON: It is a big number. Would you agree?

23 MR. BIRMINGHAM: Yes, sir.

24 MR. THOMPSON: It's an amount that's not attributable
25 to any enhanced performance by Union Gas?

26 MR. BIRMINGHAM: It is not a form of productivity
27 initiative for Union Gas, no.

28 MR. THOMPSON: It's an item that is beyond the control

1 of the utility; would you agree?

2 MR. BIRMINGHAM: Absolutely.

3 MR. THOMPSON: It is clearly in excess of the Z-factor
4 threshold specified in the agreement, of \$1.5 million per
5 year?

6 MR. BIRMINGHAM: The Z-factor threshold factor of 1.5
7 million pre-tax per year, would see all of these changes
8 exceed that threshold.

9 MR. THOMPSON: Now with respect to this amount, the 80
10 million, am I correct 8 million of it is already baked into
11 2008 rates, by virtue of the Board's interim order?

12 MR. BIRMINGHAM: I'm not following that question, Mr.
13 Thompson. The \$8 million has been held outside of our
14 interim rates.

15 MR. THOMPSON: Well, maybe I am not reading the
16 decision properly.

17 Where have I put that? Excuse me, Mr. Chairman.

18 The Board issued a decision, and as I recall, interim
19 order on March 4th, 2008, with respect to the settlement;
20 and there was an attachment to the settlement agreement
21 that talked about \$8 million being credited to 2008 rates,
22 and then there's a deferral account built around the 8
23 million. Have I got that straight?

24 MR. BIRMINGHAM: Yes, you do have that straight.

25 MR. THOMPSON: All right. So 2008 rates are lower by
26 \$8 million. That, as I understand it, is attributable to
27 the first tranche of the 80 million that is shown in your
28 exhibit.

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Volume 4

1 regulatory simplicity, so you reduce the cost of the
2 regulatory process.

3 MR. THOMPSON: All right. My last topic is
4 implementation, Mr. Birmingham. I will ask you this.

5 Assume that the Board agrees with ratepayer
6 representatives that part of the tax reductions is to be
7 accorded Z-factor status. Assume the percentage of 75
8 percent for the purposes of this discussion.

9 Do you have any recommendations for us as to how that
10 feature of the Board's decision should be implemented year
11 by year? Is there --

12 MR. BIRMINGHAM: I think the main recommendation that
13 I make, Mr. Thompson, is that it be done on actual numbers.

14 So while we have used the 2007 Board-approved for
15 capital additions, for taxable income, and for taxable
16 capital, you actually want to take those amounts on an
17 actual basis and determine what they are after the year
18 end.

19 MR. THOMPSON: Right. So that would be part of the
20 annual rate presentation process?

21 MR. BIRMINGHAM: I suspect it would be more the -- it
22 would depend on the timing.

23 I think the issue will be you will want to get to year
24 end actual amount, but our rate-setting is done on a
25 prospective basis, so we would have to determine how that
26 process would work. But one way or the other, you would
27 want to be dealing with actual numbers.

28 MR. THOMPSON: Is that the way it is being handled in

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1 the Enbridge settlement; do you know?

2 MR. BIRMINGHAM: I don't know. ✓

3 MR. THOMPSON: In terms of the allocation of tax
4 reductions to rate classes, am I correct that that is --
5 the allocation factor used to do that is the same factor
6 that is used to allocate return?

7 MR. BIRMINGHAM: That's generally true, yes.

8 MR. THOMPSON: Thank you very much. Those are my
9 questions.

10 MR. KAISER: Mr. Buonaguro.

11 **CROSS-EXAMINATION BY MR. BUONAGURO:**

12 MR. BUONAGURO: Thank you, Mr. Chair.

13 We sent out some material last Friday that we thought
14 we might be using in cross-examination. I gave copies to
15 Board Staff. When we sent them out on Friday, we sent out
16 the entire PDFs with the entire articles in them. We
17 prepared paper copies. We just have extracts that we might
18 be referring to.

19 MR. MILLAR: Exhibit K4.4, and these are VECC cross-
20 examination materials.

21 **EXHIBIT NO. K4.4: VECC CROSS-EXAMINATION MATERIALS.**

22 MR. BUONAGURO: I have copies for the panel, if they
23 don't have them already.

24 DR. MINTZ: What's the article?

25 MR. BUONAGURO: Well, this is all a preface to say
26 that we're probably not going to refer to many or all of
27 them in cross-examination, because most of our cross-
28 examination has been covered by Mr. Shepherd in his very

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1 yesterday.

2 DR. WILSON: I don't know whether I agree with that
3 statement, but to the extent that the pass-through is
4 sluggish, then there's a smaller impact on domestic prices
5 of the exchange rate, either appreciation or depreciation.

6 Whether or not, I think it is more relevant as a
7 short- to medium-term issue, than a long-run issue. It
8 would be surprising if in the very long run, there wouldn't
9 be a full pass-through, because, you know, sort of a
10 fundamental view of the determination of exchange rates in
11 the long run is purchasing power parity, which would imply
12 complete pass-through.

13 MR. BUONAGURO: Okay. Thank you. Those are my
14 questions.

15 MR. KAISER: Thank you. We'll take the morning break
16 and come back in 15 minutes.

17 --- Recess taken at 11:15 a.m.

18 --- Upon resuming at 11:42 a.m.

19 MR. KAISER: Please be seated.

20 Mr. Warren, did you have questions of this panel?

21 MR. WARREN: I do, sir, very briefly.

22 **CROSS-EXAMINATION BY MR. WARREN:**

23 MR. WARREN: Panel, much against my years of
24 professional training and my personal instincts, I want to
25 try and get to an understanding of what's fair in all of
26 this.

27 Let me start with some basic propositions. Mr.
28 Birmingham, as I understand your answer to Mr. Buonaguro

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1 earlier this morning, under a cost-of-service regime, the
2 benefits of any corporate tax reductions that would be
3 flowed through to ratepayers. Have I got that correctly?

4 MR. BIRMINGHAM: The forecast tax expense for the
5 cost-of-service period would then be reflected in our
6 application and our rate proposals.

7 MR. WARREN: I will take that as a yes. Thank you,
8 Mr. Birmingham.

9 Now, Mr. Birmingham, a principle, a regulatory
10 principle, was advanced by Mr. Thompson, and I would like
11 you to respond to it.

12 Can you and I agree, Mr. Birmingham, that under an
13 incentive regulation regime, one of, though not the only,
14 regulatory principles is that ratepayers should be no worse
15 off than they were under a cost-of-service regime?

16 MR. BIRMINGHAM: I would say, in aggregate, I would
17 agree with that principle.

18 MR. WARREN: Does it follow from the two answers,
19 then, Mr. Birmingham, that what we are all collectively
20 engaged in, obviously with differing interests, but what
21 we're collectively engaged in is finding a way to ensure
22 that the \$80 million in forecast corporate tax reductions
23 finds its way into the hands of the ratepayers, and we're
24 trying to find the mechanism by which to do that? Is that
25 a fair summary of what we're engaged in?

26 MR. BIRMINGHAM: I think that's probably right, Mr.
27 Warren, particularly when I think about it in the context
28 of -- if these income tax changes were unique to Union and

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1 there were no macroeconomic impacts, then in that
2 circumstance, that would be a pass-through.

3 So I think that is right. We're trying to determine
4 whether there is any, I guess, further need for an
5 adjustment. It is certainly our position there isn't.

6 MR. WARREN: I understand that. Now, if I could turn
7 to the other two members of the panel, and at the
8 vertiginous risk of plunging into macroeconomic theory, let
9 me see if I can understand what you said over the last
10 couple of days.

11 It would help if you would turn up one of your
12 interrogatory responses to Mr. Shepherd's client, and it is
13 Exhibit E3.3.8.

14 DR. WILSON: E3. --

15 MR. WARREN: E3.3.8.

16 DR. WILSON: I've got it.

17 MR. WARREN: In response to the question that was
18 posed to you, you said:

19 "Precise calculations of the reduction in
20 aggregate prices from corporate tax reductions on
21 a year-by-year basis are not feasible. The
22 adjustment of aggregate prices over the 2007 to
23 2012 period will include the lagged effects of
24 tax reductions implemented before 2007.
25 Furthermore, the adjustment to tax reductions
26 implemented after 2008 may not be fully realized
27 by 2012."

28 Have I read it accurately?

1 seems to me to be an accurate reflection of what is
2 happening. I don't know what others --

3 MR. SHEPHERD: I agree. I think that disaggregation
4 of the impacts is really important for the Board to
5 understand. The one thing I would add is, on the timeframe
6 that my friend is talking about -- I understand this is not
7 a trivial task -- but on that timeframe, then, you wouldn't
8 have the benefit of any of the other experts looking at
9 those results. And we wouldn't have the opportunity to
10 respond.

11 I don't know whether this is an answer to that, but I
12 think it obviously has to be raised.

13 MR. KAISER: Well, I guess we will have to deal with
14 that as it unfolds. We will have the material. We will
15 find out, number 1, when the material can be made
16 available. Then you will have a chance to look at it. If
17 we have to deal with further responses, we can consider
18 those requests.

19 Any re-exam?

20 MR. PENNY: Yes, thank you, Mr. Chairman. I think I
21 just have two areas, probably both for Mr. Birmingham.

22 **RE-EXAMINATION BY MR. PENNY:**

23 MR. PENNY: Mr. Birmingham, with respect to the cross-
24 examination of Mr. Thompson, I had a sense of, perhaps
25 ships passing in the night on some of the questions and
26 answers about the numbers.

27 So if you would look at Exhibit 3.1.1, which Mr.
28 Thompson asked you about.

1 I am focussing on the base rate adjustment issue that
2 Mr. Thompson cross-examined on. If you were to modify this
3 schedule, in which we were not asked to identify 2007
4 changes, but only 2008 and subsequent changes - that was
5 the question, so that's why the 2007 isn't in here - but if
6 you were to modify this by adding the known tax changes
7 that were implemented in 2007, what would it look like? Or
8 what change would be made?

9 MR. BIRMINGHAM: Okay. I thought I answered that
10 question, but let me give it another try.

11 Maybe the simplest way to explain it is: You would
12 add a column for 2007 to the chart, Exhibit E3.1.1. And
13 under the column of 2007, at line 20, you would put a
14 million dollars, which is the CCA rate impact that is found
15 on Exhibit E3.1.4.

16 Then further down that column, on line 30, you would
17 put "zero" because there were no unforecasted variances in
18 the income tax rate changes for 2007.

19 Then finally, further down in that column, at line 38,
20 you would add 1.8 million, which is the capital tax rate
21 impact, also from Exhibit E3.1.4.

22 So that would be the total of 2.8 million for 2007.
23 And that would impact each year beyond 2007. So the
24 cumulative impact that shows now at 80.51 million would be
25 increased by 14 million --

26 MR. PENNY: So --

27 MR. BIRMINGHAM: -- as a result of adding that 2.8.

28 MR. PENNY: The cumulative effect of just the million

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1 and the 1.8 over the five years is how much?

2 MR. BIRMINGHAM: It is 2.8 million for one year and 14
3 million in its entirety.

4 MR. PENNY: All right. Thank you. Then the final
5 question on that, Mr. Birmingham is, if the --

6 MR. THOMPSON: Sorry, what was the last number you
7 said? Fourteen?

8 MR. BIRMINGHAM: 2.8 million by five years.

9 MR. THOMPSON: That I understood.

10 MR. PENNY: And sorry, Mr. Birmingham, is the future
11 effect of the one million and the 1.8 million that we would
12 add to 2007, is that already captured in the numbers that
13 are on this exhibit? Or not?

14 MR. BIRMINGHAM: It is not.

15 MR. PENNY: And then my final question on this, Mr.
16 Birmingham, is that if the Board decided that only a base
17 rate adjustment for those known tax changes in 2007 was
18 warranted - in other words, they otherwise agreed with
19 Union that future tax changes will be captured in the GDP
20 deflator - what would be the amount of the base rate
21 adjustment that would be warranted?

22 MR. BIRMINGHAM: Well, first of all, I don't agree
23 that there should be a base rate adjustment. This is an
24 unforecast variance, and we don't make adjustments to our
25 base rates for any of the other elements of our cost of
26 service for unforecasted variances.

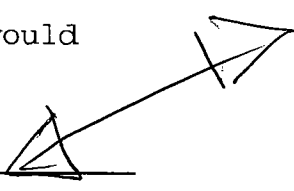
27 But if the Board was to make an adjustment, it would
28 be for the total of \$2.8 million.

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E3.11



1 MR. PENNY: Thank you. Then arising from some
2 questions we just had about the relationship between
3 forecasts under cost of service and the influence of
4 inflation under incentive regulation, I just had, I think,
5 three questions.

6 Your forecast cost of service in a cost-of-service
7 hearing, as I understand it, includes your best estimate of
8 all costs and revenues in the test period that you think
9 you will actually experience.

10 MR. BIRMINGHAM: That's correct.

11 MR. PENNY: You do not, in that forecast, restrict
12 your forecast just to the effects of inflation?

13 MR. BIRMINGHAM: No.

14 MR. PENNY: Under incentive regulation, you are living
15 within the rate derived from the inflation factor and the
16 productivity dividend alone, regardless of what costs and
17 revenue pressures you actually think you are going to
18 experience?

19 MR. BIRMINGHAM: That's correct.

20 MR. PENNY: All right. Thank you. Those are all of
21 my questions.

22 MR. KAISER: Thank you. All right. We will come back
23 in an hour for the next witness. Thank you, gentlemen.

24 --- Luncheon recess taken at 12:40 p.m.

25 --- Upon resuming at 1:50 p.m.

26 MR. KAISER: Please be seated.

27 Mr. Warren.

28 MR. WARREN: Thank you. Thank you, Mr. Chairman,

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1 And, as I said, the division of labour between I and
2 my colleagues - and I also consulted with Professor Mintz
3 by phone on this - and the Union Gas, Mr. Packer and his
4 colleagues, was that we were responsible for looking at
5 impacts on the GDP final demand deflator, taking into
6 account distributed lag effects, taking into account
7 anticipatory effects, doing the kind of sensitivity
8 analysis that we present in table 3.

9 Mr. Packer and his colleagues took it the next steps
10 to see how that impacted on Union's financial statements.

11 MR. THOMPSON: Well, let me come back to you, Mr.
12 Packer, to pursue this a little further.

13 Can we agree that what we're talking about in this
14 time frame, 2008 to 2012, in terms of the tax reductions,
15 is the \$80.51 million, which is the sum of the items shown
16 in line 17 of table 1? I know that is an estimated number,
17 but that's what all of these calculations are based on.

18 MR. PACKER: I would say, based on how the undertaking
19 was framed, that's part of it. I think what parties were
20 trying to understand is how the impacts tax changes were
21 having on the GDP deflator and the pricing formula compared
22 to that number.

23 MR. THOMPSON: But the amount of the reductions that
24 you have used in this analysis is \$80.51 million; correct?

25 MR. PACKER: That's the calculation under the revenue
26 requirement approach, yes.

27 MR. THOMPSON: Right. And let's assume the question
28 that the Board is interested in is: How much of that

1 amount is absorbed by reductions in the GDPPI occurring in
2 '08 to 2012 as a result of those tax reductions?

3 Do you understand the assumption I put to you?

4 MR. PACKER: I think I do.

5 MR. THOMPSON: I suggest to you that if we look at
6 your table or tables to answer that question, what we look
7 at are lines 9, 10, 11 and 12. Am I correct, Professor
8 Wilson?

9 DR. WILSON: No. Well, because of the regulatory lag,
10 you've got to take into account the '06/07 GDPPI change,
11 because that is what is being used, as I understand it, in
12 the first year of the IR price cap system.

13 And because of the -- and these -- so in this table,
14 that total '6/7 is showing up as a 2008 number. As I
15 indicated, the regulatory lag is built into this table.

16 The 2012 number would be based on the 2011 over 2010
17 change, again because of the regulatory lag.

18 And by saying that, I don't mean -- we know why that's
19 there, because you don't have the data for the year in
20 question. You have to depend on data from the previous
21 year when you hold your hearing or when you decide what the
22 rate going forward should be.

23 MR. THOMPSON: But is not the -- Mr. Packer, the 2007
24 tax reduction picked up in the 2007 revenue requirement
25 determined by this Board, plus the deferral account, plus a
26 base year adjustment to reflect that amount? Isn't that
27 how that reduction is captured?

28 MR. PACKER: Not appropriately, no. That's the way --

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1 secondly, the materiality threshold.

2 I guess under your set of assumptions and the impacts
3 that are being shown here, it appears as if it would.

4 MR. THOMPSON: Now, my last question, then, is in
5 terms of implementing any Z-factor treatment that the Board
6 finds to be appropriate, let's assume it's either your line
7 22 or my line 22 where we have numbers at each column that
8 exceed the materiality threshold of \$1.5 million. Should
9 we be doing this, in Union's view, on a year-by-year basis?
10 Or should we express the unabsorbed amount, if you will, as
11 a percentage of the 80.51, and approach it that way?

12 MR. PACKER: I think Mr. Birmingham testified earlier
13 that he would prefer that we do the calculations annually,
14 using the actual numbers that appear in each year.

15 So consistent with that, if the Board was to make an
16 adjustment, I think the preference would be that it would
17 be done annually, rather than having some predefined
18 calculation that smoothed it out.

19 MR. THOMPSON: All right. Thank you very much. Those
20 are my questions.

21 **FURTHER QUESTIONS FROM THE BOARD:**

22 MS. CHAPLIN: Mr. Packer and Dr. Wilson, I actually
23 have a question of clarification before you leave for now.

24 On the determination of the 80.51 million from E3.1.1,
25 that was an examination just of the corporate tax changes?
26 Am I correct?

27 MR. PACKER: Well, it captures the three tax changes
28 that have been raised in the context of this proceeding,

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EB-2007-0606
EB-2007-0615

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 an Application by
Enbridge Gas Distribution Inc. for an Order or Orders
approving or fixing rates for the distribution,
transmission and storage of natural gas, effective
January 1, 2008;

AND IN THE MATTER OF a combined proceeding
Board pursuant to section 21(1) of the *Ontario Energy
Board Act*, 1998.

BEFORE: Gordon Kaiser
Presiding Member and Vice Chair

Paul Sommerville
Member

Cynthia Chaplin
Member

DECISION

July 31, 2008

INTRODUCTION

This decision relates to an Application filed by Union Gas Limited ("Union") on May 11, 2007 under S.36 of the *Ontario Energy Board Act* for an Order of the Board approving or fixing a multi-year incentive rate mechanism to determine the rates for the regulated distribution, transmission and storage of natural gas effective January 1, 2008.

On January 3, 2008, the parties reached an agreement on most of the issues in this proceeding and on January 17, 2008, the Board approved that Settlement Agreement (dated January 3, 2008) which included an addendum dated January 14, 2008.

This decision addresses three matters which were not settled: two issues related to taxes and one issue related to risk management.

The first tax issue to be decided is whether a series of tax reductions that will be applicable to Union during the Incentive Regulation ("IR") plan should be passed on to ratepayers through a "Z factor" adjustment. The key consideration is the extent to which changes in tax rates which occur within the term of Union's IR Plan are captured in the national inflation factor, as measured by the Gross Domestic Product Input Price Index for Final Domestic Demand, component of the price cap formula. The second issue respecting taxes is whether an adjustment to Union's 2007 base rates should be made for tax rate changes that became effective in 2007 but were not reflected in the cost forecast underpinning the applied for rates.

The issue with respect to risk management is whether the costs associated with the company's risk management activities should continue to be recovered from ratepayers. This issue is addressed following the tax issues.


TAX REDUCTIONS DURING THE TERM OF THE IR PLAN

The Settlement Agreement provides that during the term of the five-year IR Plan, any rate increases would be limited by a price cap which is a function of the inflation factor, minus a productivity or "X" factor. The parties have agreed on a specific "X" factor and the manner in which the inflation factor is to be calculated. They have also agreed on the qualifying characteristics of the "Z" factor, an

additional adjustment which can be made when unforeseen events take place that are beyond the control of Union. Section 6.1 of the Settlement Agreement provides that to qualify for "Z" factor treatment, an event should meet the following criteria:

1. the event must be related to an increase/decrease in cost;
2. the costs 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 or decrease must not otherwise be reflected in the price cap index;
4. any cost increase must be prudently incurred; and
5. the cost increase or decrease must meet the materiality threshold of \$1.5 million annually per Z factor event.

A variety of tax changes were announced in 2007, including reductions in federal and provincial income and capital tax rates and changes in capital cost allowance rates, to be implemented in 2007 and throughout the IR period. The question to be decided is whether the tax changes will work their way through the economy so that they are reflected in the price cap index through the inflation factor. If the changes are not thought to be so reflected, then they qualify for Z factor treatment.

 In this proceeding, the value to Union of the tax reductions forecasted to take place during 2008-2012 IR period was estimated at about \$80 million.¹ Union says that these tax reductions should not be Z factored or passed on to ratepayers because they will be reflected in the inflation factor. As a result, Union argues, to pass them on to ratepayers in whole or in part, would mean ratepayers benefit twice.

Six major Intervenor groups submitted detailed arguments on this issue, the Consumer Counsel of Canada ("CCC"), the Industrial Gas Users Association ("IGUA"), the Vulnerable Energy Consumers Coalition ("VECC"), the School

¹ This impact includes the impact of tax reductions in 2007 on tax costs in subsequent years. The specific treatment of that aspect is dealt with as a separate issue in the next section.

Energy Coalition ("SEC"), the City of Kitchener ("Kitchener") and London Property Management Association ("LPMA"). The LPMA group also included the Building Owners and Managers Association of Greater Toronto ("BOMA") and Wholesale Gas Service Purchasers Group ("WGSPG").

Enbridge Gas Distribution Inc. ("Enbridge") was also an Intervenor. It supported Union's position on the issue.

All of the other Intervenor's opposed Union's position. They claim that the tax reductions will not be wholly incorporated in the inflation factor during the term of the IR plan and therefore should be given Z factor treatment.

Previous Union Decisions

This is not the first time that consideration of the impact of a tax reduction on the inflation factor during an IR Plan has come before this Board. Union raised the same issue in its previous PBR² plan which covered the period 2001 to 2003. The issue there was whether the reduction in Ontario income tax for 2001 and 2002 should flow through to ratepayers as a Z factor. In its decision setting the 2000 rates and adopting the PBR methodology (RP-1999-0017), the Board concluded:

For example, in the case of changes in provincial income taxes, the Board doubts that this will be fully reflected in a Canada wide GDPPI and in any event would be concerned about a time lag involved. (para 2.318).

The Board went on to direct Union as follows:

The Board directs Union to track the effect of changes in the Ontario Income Tax and to bring forward the cost changes to be considered through the customer review process as an adjustment to rates." (para. 2.318)

Union tracked the tax changes which turned out to be a reduction of \$1.57 million for 2001 and \$3.85 million in 2002.

² PBR refers to "performance based regulation"

In the subsequent case, which set rates for 2002 and 2003 (RP-2001-0029), Union called Professors Jack Mintz and Tom Wilson (as it did in the current case), and their evidence was essentially the same as in the current case. They stated that "attempting to adjust for lags and relative weightings of the Ontario Provincial Income Tax rate changes in GDPPI would add unnecessary complexity and is not possible with any accuracy".³ They argued that the tax reductions would flow through to GDPPI, a position the Board accepted.⁴ The Board concluded:

There may be instances where a tax change is of such a nature that 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 cannot reliably be expected to be reflected in a Canada-wide index such as GDPPI. (para 5.29)

... 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. (para 5.31)

The Board accepted that tax reductions flow through to the inflation index notwithstanding the possibility of leads and lags.

Union argued in the current proceeding that the panel should treat this prior decision as a precedent. While Union conceded that the prior decision is not binding on this panel, it says the Board should be consistent in its decision making. It is noteworthy however, that the evidence and the position of the parties in that proceeding were different. Paragraph 5.25 of that decision observed:

Regarding the "lead/lag issue", Union noted that Kitchener, LPMA, and WGSPG accepted its evidence. Union added that there was no evidence on what the lead or lag is or on how one would adjust for it and later reverse the adjustment. Incorporating lag effects, Union

³ RP 2001- 0029, Exhibit B, Tab 15, para 2 of 2.

⁴ RP-2001-0029, *Decision with Reasons*, September 20, 2002

submitted, would require assessing the impacts of past as well as current tax changes.

Here, there has been detailed evidence regarding the lags. All the Intervenors, except Enbridge, opposed Union with many saying that only 10% of the tax reductions flow through to the index during the term of the IR Plan.

The Quantitative Evidence

A substantial body of quantitative evidence was tendered by various experts. As noted above, Union relied on the evidence of Professor Jack Mintz of the University of Calgary and Professor Tom Wilson of the University of Toronto. Board Staff called Dr. Mark Lowry of the Pacific Economics Group. CCC, VECC and Kitchener called Dr. Robert Loube of Rolka Loube and Salzer Associates. SEC called Dr. George Georgopoulos of York University.

The Union position in this proceeding is similar to the position it advanced in RP-2001-0029 with the same witnesses. However, this case is different in a number of respects.

In this case, the Intervenors chose to call expert evidence that questioned whether the tax reductions that would occur within the IR period, 2008-2012, would all be reflected in the index in that period. Dr. Loube recommended that at a minimum 75% of the corporate tax reduction should be treated as a Z factor, and that, at a maximum, 25% of the corporate tax reduction could be assumed to be reflected the inflation factor. Dr. Georgopoulos posited that prices will not fall to the extent that consumers will get the full benefit of the corporate tax cut. Dr. Lowry, on the other hand, concluded that absent solid evidence that the inflation factor will respond inappropriately to the tax reductions, it would be reasonable for the Board to reject Z factor treatment for any part of the reductions. In short, the controversy in the proceeding is whether it is sufficient to demonstrate that the tax reductions will flow through to the price cap index "sooner or later" or whether it must be demonstrated that they flow through within the exact period covered by the IR plan.

The initial evidence of Professors Mintz and Wilson did not consider the lag between the time the subject tax reductions were effected and their reflection in the inflation factor. The Union witnesses conceded that there would be lags in

the manner in which the tax reduction impacted the inflation factor, but argued that if those lags were considered, Union was entitled to consider the tax reductions that occurred in prior periods. These would compensate for the later lags.

The issue is crystallized in the response by Professors Mintz and Wilson to an SEC interrogatory.⁵

Question:

Please provide your calculation of the reduction in GDPIPIFDD that can reasonably be expected to arise in each of the years 2007 through 2012 as a result of the announced changes in federal corporate tax rates, federal CCA rates and Ontario capital tax rates, assuming each is implemented as currently scheduled. If you are unable to calculate the impact on GDPIPIFDD, please explain why, and provide instead your calculation of the annual reductions in CPI (All Items) instead.

Response

Precise calculations of the reduction in aggregate prices from corporate tax reductions on a year-by-year basis are not feasible. The adjustment of aggregate prices over the 2007-2012 period will include the lagged effects of tax reductions implemented before 2007. Furthermore, the adjustment to tax reductions implemented after 2008 may not be fully realized by 2012.

There seems to be little dispute between the parties that ultimately the tax reductions will flow through the inflation factor. It is a question of the relevant period or whether prior period lags should be considered.

The Intervenors pointed out that the Settlement Agreement specifically refers to the impact of tax reductions of \$80 million (the in-period tax reductions) not prior reductions. Union responded that the meaning of the Z factor is set out in the Settlement Agreement which states "the increase/decrease must not otherwise

⁵ Exhibit E.3.3.8

be reflected in the price index.” Union noted there is nothing in the definition in the Settlement Agreement which states when the price reduction has to be reflected, merely that the reduction “must not otherwise be reflected”.

The Intervenors also argued that, as a matter of general regulatory principle, consumers should be no worse off under an IR plan than they would be under cost of service regulation. They stated that it is counter-intuitive that at the beginning of the IR period, Union should receive a windfall gain of \$80.5 million. As Professor Wilson agreed, the \$80 million tax reduction is a windfall gain which was caused by events entirely beyond Union’s control and had nothing to do with productivity gains initiated by Union.⁶ Under a cost of service regime these cost reductions would flow through to the customer at each cost of service rates application.

In essence, Union asserts that lags should not be taken into account and that the tax reductions will find their way in to the inflation factor and the price cap index ultimately. Alternatively, Union argued that if lags are to be taken into account then prior period lags should be also considered. It is to be noted that there were significant tax reductions in the prior period.

The Intervenors, on the other hand, argued that prior period tax reductions should not be considered and that the tax reductions at issue are those that occur within the specified IR term. If prior tax period reductions are eliminated, they claim that only a fraction of the tax reductions will flow through to the price cap index during the IR term.

Board Findings

This is a difficult question with a large amount of conflicting evidence. But the principles are relatively straightforward. In order for an IR plan to be successful, it is important that the parties believe it is fair at the outset. There is expected to be a large reduction in taxes over the period. It is understandable why the Intervenors are concerned that ratepayers would lose the benefit of an estimated \$80.5 million cost reduction at the very outset of the plan. Such a reduction would clearly enure to the benefit of ratepayers if the company were subject to cost of service regulation.

⁶ Tr. Vol. 4, p. 65

On the other hand, it is accepted by all of the experts that tax reductions operating generally within the national and the provincial economies will flow through to the inflation factor over time. There is no dispute that the tax reductions at issue are of this nature.

The question is when the effect of the reductions will flow through to the inflation factor. This Board in RP-2001-0029 did not require Union to demonstrate that the tax reductions would find their way, in their entirety into the inflation factor within the specific term of the IR plan. This approach has also been adopted by regulators in other jurisdictions including the Federal Communications Commission in the United States⁷ and the CRTC in Canada.⁸

In the circumstances, the Board believes that the fair solution is to treat 50% of the tax reductions as a Z factor.

This conclusion recognizes that while tax changes do flow through the inflation factor, this process is subject to some significant lags. We cannot know now the precise structure and form of the rate setting mechanism following this IR period, and therefore we cannot know now whether or how all of the impacts of the tax reductions will flow through to ratepayers after the IR period. This suggests that some sharing during the current IR period is appropriate. While we cannot conclude with any certainty the precise amount of the tax reduction which will effectively flow through the inflation factor during current IR period, the evidence indicates that it will be substantially above zero and substantially less than 100%.

Our conclusion is that a 50/50 sharing of the impact of tax changes, as applied to the tax level reflected in the 2007 Board-approved rates, is a reasonable balance. The approach used in Exhibit E3.1.1 is indicative of how the savings are to be calculated for purposes of the sharing.

The Board notes that the 50% allocation was the same solution the parties agreed to in the Enbridge case. That is not the reason for the Board's decision here. We do not treat the Enbridge case as a precedent any more than we treat the RP-2001-0029 decision as a precedent. But it may be some comfort that both gas utilities under the Board's jurisdiction have the same result regarding this particular Z factor.

⁷ In the Matter of Policy and Rules Concerning Rates for Dominant Carriers (1989) 4 FCC Red 2873, 1989 FCC Lexis 860 at para 272; 1990 FCC Lexis 5301 at para 178

⁸ CRTC Telecom Decision 97-9 (May 1, 1997) at para 105

THE BASE RATE ADJUSTMENT

Union's 2007 cost of service filing contained certain cost of service reductions relating to income tax. However, other tax reductions, announced later, were not factored into the company's rates. Further tax reductions were announced after Union's 2007 cost of service proceeding with a resulting cost reduction in 2007 of approximately \$2.8 million. These cost savings were credited to customers in the Board's decision in EB-2008-0034, dated June 3, 2008. What is in dispute is whether Union's base rates should be adjusted so that the cost reductions over the IR plan arising from the 2007 tax reductions flow through to ratepayers. All of the Intervenor took the position that the tax reductions implemented in 2007 should be incorporated in the base rates before the application of the price cap index.

Union opposed this on the basis that this is an unforeseen test year cost variance which is indistinguishable from many other forecast test year cost variances. Accordingly, Union argued that no adjustment should be made. Union relied on the Board's Natural Gas Forum Report⁹ which supports the proposition that a robust base rate setting process should occur in advance of incentive regulation. Union also relied on the evidence of Dr. Lowry (called by Board staff) for the proposition that once base rates are set, the Board should be reluctant to change those rates during the term of the IR plan.

Counsel for IGUA pointed out that these costs are not the product of any efficiencies produced by Union and that the tax changes are matters entirely beyond Union's control. IGUA also noted that the impact of the tax change on 2007 costs is being accorded deferral account treatment.

Board Findings

The Board agrees that as a general proposition, adjustments should not be made to base rates once they are set. However, for the reasons set out above, the Board finds that the 50 % impact during the IR period arising from the 2007 tax reductions should be subject to Z factor treatment.

The Board notes that the tax reductions meet the agreed criteria for a Z factor.

⁹ *Natural Gas Regulation in Ontario: A Renewed Policy Framework*, March 30, 2005

First, the tax reductions are a material cost decrease which impact costs in 2008¹⁰, and throughout the IR period, and is beyond the control of Union's management. Second, as the Board has concluded above, the impact of tax reductions is only partially captured by the inflation factor. The Board concludes that it is appropriate for these tax reductions to be treated in a manner which is consistent with the treatment afforded tax changes which are implemented during the term of the IR plan.

RISK MANAGEMENT

The Settlement Agreement proposed that the Board deal with the Risk Management issue by way of written submission and that no oral evidence was required. The Board received submissions from the Consumer's Council of Canada ("CCC"), the Vulnerable Energy Consumers Coalition ("VECC"), the Ontario Energy Savings Limited Partnership ("OES"), Energy Probe and the City of Timmins. Energy Probe, OES, and the City of Timmins opposed the continuation of the risk management program; VECC and CCC supported the program's continuation.

Union's 2007 Decision

In Union's 2007 rates application (EB-2005-0520) the company maintained that its risk management activities had provided customer benefits in terms of reduced volatility in the magnitude of the rate riders necessary to clear the Purchased Gas Variance Account ("PGVA").

Energy Probe and natural gas marketers opposed the program, noting that the smoothing effect on price volatility impairs competition. The Board, in its decision dated June 29, 2006, rejected this claim, noting that reduced volatility was consistent with its consumer protection objective and that the Quarterly Rate Adjustment Mechanism ("QRAM") and the PGVA processes have as their objective the smoothing of bills and prices. Other intervenors objected on the grounds that it undermined conservation efforts; the Board similarly rejected this argument.

IGUA objected to the program on the basis of its limited efficacy. The Board

¹⁰ The impact of the reduction in costs in 2007 has already been credited to customers as described earlier in this decision.

noted that Union's evidence was that the effect of risk management on the PGVA was modest – and overall bill impact of less than 1%, but a reduction in the range of the PGVA rate riders of about 30%.

The Board concluded that while the QRAM is the main smoothing technique, the risk management program provided additional smoothing at a modest cost. The Board approved the associated O&M costs and the continuation of the program.

Enbridge's 2006 and 2007 Decisions

Enbridge's risk management program has also been the subject of a number of prior Board decisions. A summary of that history is useful for purposes of this decision.

In the decision on Enbridge's 2006 rates (EB-2005-001, February 9, 2006), the Board stated:

The question that remains is the extent to which Enbridge's risk management program is redundant or represents a useful and cost effective tool to reduce consumer price volatility in a fair and reasonable way...No evidence has been provided that demonstrates whether the hedging activity had a material effect on the volatility experienced by customers, given the effects of QRAM, the PGVA, and equal billing programs over the same period.¹¹

Enbridge was directed to prepare evidence related to the volatility experienced by customers resulting from its hedging activities.

In the Enbridge 2007 rates proceeding (EB-2006-0034), the company's evidence was that its risk management activity reduced volatility in the PGVA reference price in the range of \$1 and \$2 per 10³m³. Enbridge noted that risk management was a common activity amongst gas utilities in North America and that the activity had the support of its customers and a recognized expert (RiskAdvisory), as well as past Board decisions.

What was at issue was whether Enbridge had demonstrated that its risk

¹¹ EB-2005-001 *Decision with Reasons*, February 9, 2006, p.30.

management program had a material effect on the price volatility experienced by customers. The Board in its July 5, 2007 decision found that the program was not of value to customers on the budget billing plan. The Board found that the reduction in the PGVA price volatility was small relative to the prevailing PGVA reference price. The Board noted the large accumulated losses in the program since 2002 and concluded that this was a high cost for customers. The Board also noted the intergenerational impacts of losses and gains in the program, noting in particular the loss of \$110 million in 2006. The Board concluded:

The Company's and Energy Probe's evidence have satisfied the Board that the rate smoothing attributable to the Company's risk management program for the remaining system customers not on equal billing is marginal at best. While the annual costs of operating the program are of lesser concern to the Board, the intergenerational impacts in light of the substantial losses are of significant concern.

Given the program's minimal impact on the other system customers not currently on equal billing, the impact will likely be unnoticed by these customers. For these customers, the option is still available to take advantage of the Company's equal billing plan if they so choose.

For all of the above reasons, the Board directs the Company to cease its risk management program as soon as practical.¹²

The Current Proceeding

Union in the current proceeding explained that its risk management program is unchanged from the program approved by the Board in EB-2005-0520. Union argued that it had been successful in reducing volatility in its gas costs (by 31%) and reducing the volatility in its PGVA. Union's evidence was that the PGVA rate riders were reduced by 14% and the volatility of rate riders was reduced by 17%.

Union also noted that small cost is associated with this program. Over the period 2002 to 2006, the cost was \$0.02/GJ or 0.3%. Union noted that the cost of risk

¹² EB-2006-0034 *Decision with Reasons – Phase 1*, [July 5, 2007], p. 46.

management has never exceeded 6% of gas costs in terms of mark to market. The net cost over five years has been \$3.4 million.

Union also filed an independent report by Risk Management Incorporated ("RMI") which supports the continuation of Union's risk management activity.

Union submitted that the QRAM and Equal Billing Program perform a complementary function, but are not a substitute for risk management:

Risk management affects Union's ultimate cost of gas which is passed on to customers. The QRAM and EBP merely smooth customers' bill payments. Generally, the QRAM smoothes the *rate* customers pay while the EBP smoothes the *consumption*. In the event of price volatility induced by either supply or demand fundamental, customers are subject to the price impacts and price volatility irrespective of the QRAM or whether they are on the EBP.¹³

Union noted that only 39% of its customers use the Equal Billing Plan.

Union's evidence was that risk management works to minimize the variance between the QRAM price and the actual gas costs, thereby decreasing the actual size of the PGVA. In Union's view, to the extent that risk management reduces the size of the PGVA, it reduces inter-generational impacts.

Positions of the Parties

VECC and CCC supported the continuation of Union's risk management activity. CCC submitted that the Board has no evidence to contradict Union's position that the program provides value to customers in terms of reducing volatility. CCC further argued that it was premature to eliminate the program before the Board's anticipated broader review of system supply issues.

The City of Timmins submitted that Union and Enbridge should be treated consistently, unless there were extraordinary differences. Timmins also took the position that 6% of total gas costs did not represent a small cost.

¹³ Argument in Chief, p. 5.

Ontario Energy Savings L.P. ("OES") also opposed the continuation of the risk management activity, taking the position that there was no material impact on volatility experienced by customers and that the program was contrary to the Board's objectives related to competition, conservation and consumer education. Union replied that there was no evidence of an adverse impact on competition or conservation and noted that these assertions were rejected by the Board in EB-2005-0520.

Energy Probe also opposed this program. It pointed out that while the cost from 2002 to 2006 was \$3.4 million, the net loss over the period 2002 to August 2007, excluding administrative costs, is \$22.7 million (Ex. JTA.26b). Energy Probe noted that while Union had not experienced the same level of losses as Enbridge, the swing between the positive result in 2003 (\$30.4 million) and the negative result in 2006 (\$22 million) was over \$50 million and that the risk of a significant loss remains. Union replied while there was a loss incurred to the end of August 2007, the objective of the program is not to beat the market and that gains and losses will net out over time.

Energy Probe submitted that the smoothing effect of equal billing far surpassed the smoothing effect of risk management. Customers not on equal billing routinely saw their monthly bill change by between \$40 and \$60 with risk management. If risk management were eliminated, the maximum monthly bill change for a customer on equal billing would have been \$6 when compared to equal billing with risk management.

In Energy Probe's view:

Union has repeated for years its claim that risk management provides "reasonable value". In fact, risk management has raised the cost of gas and provided slight smoothing effects that are significantly overshadowed by the smoothing effects of QRAM and equal billing. Viewed objectively, there is no value gain for consumers from risk management whatsoever...¹⁴

Energy Probe concluded that the Board should direct Union to terminate its program and reduce its revenue requirement at the next rebasing to reflect this

¹⁴ Argument in Chief, p. 6.

change.

Union replied that there was nothing new in Energy Probe's arguments, and that the Board had rejected similar arguments in the last Union proceeding. Union reiterated that the evidence is that risk management has had a significant, positive impact on the size and volatility of PGVA rate riders and that there is an incremental benefit even for customers on the equal billing plan.

Board Findings

In its argument Union states "Union's risk management objectives are met through a diversified portfolio of fixed price contracts, indexed price contracts, financial hedging and supply basin diversification." What is at issue, however, is the narrow activity of financial hedging. The other activities, including Union's use of rolling 24 month fixed-price contracts, are in the area of gas supply procurement and are not being considered as part of this issue.

The evidence is clear that the risk management activity reduces volatility in Union's cost of gas, by 31% over the period 2002-2006, at an average cost of 0.3% of total commodity costs. However, the actual mark to market results while netting to \$3.4 million over the same period, have ranged from a cost of \$22 million in 2006 to a credit of \$30.4 million in 2003. What is at issue is whether the benefit to customers, in terms of reduced volatility to them, is sufficient to justify the related expense.

Risk management has reduced the size of PGVA rate riders by 14% and the volatility of those rate riders by 17%. It was on the basis of these impacts that the Board in its prior decision concluded that the program should be maintained. However, the rate rider itself has been less than 10% of the cost of gas.

The Board concludes that although the size and the volatility of the rate rider have been reduced by a material amount when expressed in percentage terms, the impact which is of relevance to customers is best observed through the bill impact. This impact has ranged from -\$51.00 to \$12.00. However, these are the annualized impacts of quarterly changes, and therefore are overstated from the perspective of customer experienced impact. The greatest impact of -\$51.00 (in the March 2003 period) represents a reduction of only \$4.25 per month for the quarter in question, and the next largest impact is only a bit over \$1.00 per

month. Most of the impacts are well below this level.

The Board agrees that in the event of price volatility customers are subject to the price impacts, but the use of the QRAM process and the equal billing plan have the effect of smoothing customer impacts generally in any event. The evidence is clear that the smoothing effect of equal billing alone far exceeds the impact of the risk management program. Union notes that only 39% of customers opt for the equal billing plan. The Board takes this to be a transparent indicator of the level of smoothing desired by customers.

Against this minimal incremental benefit, there are also modest costs. However, these costs have varied between material gains and material losses over the period. The Board understands that on a net basis there should be no gain or loss, however in comparing these swings with the marginal level of benefits, the Board concludes that there is no material net benefit for customers. As a result, the Board will disallow the recovery of the associated costs. The Board will make no consequential adjustment to the company's rates at this time, but Union is directed to record the costs, which are currently embedded in rates for the duration of the IR period, in a deferral account for disposition later. The appropriate adjustments to distribution rates will be considered at the time of Union's next rebasing.

COSTS

A decision regarding cost awards will be issued at a latter date. Eligible intervenors claiming costs that have not already been filed under phases 1 and 2 of the cost claim process for this proceeding should do so as ordered below.

The Board hereby directs:

1. Eligible intervenors claiming final costs are to file their claims by September 22, 2008 in accordance with the Board's Practice Direction on Cost Awards.
2. Union and Enbridge shall have until 14 calendar days from the date the cost claim was filed to object to any aspect of the costs claimed. The party claiming costs shall have 7 calendar days from the date of filing of the objections to file a reply.

3. 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 and Enbridge Gas Distribution Inc.

DATED at Toronto, July 31, 2008.

Original signed by

Gordon Kaiser
Presiding Member and Vice Chair

Original signed by

Paul Sommerville
Member

Original signed by

Cynthia Chaplin
Member



uniongas

A Spectra Energy Company

August 28, 2008

Ontario Energy Board
2300 Yonge Street,
27th Floor
Toronto, ON
M4P 1E4

Attention: Ms. Kirsten Walli, Board Secretary

**Re: Multi-Year Incentive Rate Regulation for Natural Gas Utilities
EB-2007-0606**

Dear Ms. Walli:

Please find attached Union's motion for a review and variance of the Board's EB-2007-0606 Decision and Order, dated July 31, 2008.

Yours truly,

[original signed by]

Mark Kitchen
Director, Regulatory Affairs

cc: All Intervenors
Michael Penny, Torys

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 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 an Application by Enbridge Gas Distribution Inc. for an Order or Orders approving or fixing rates for the distribution, transmission and storage of natural gas, effective January 1, 2008;

AND IN THE MATTER OF a combined proceeding Board pursuant to section 21(1) of the *Ontario Energy Board Act*, 1998.

NOTICE OF MOTION

1. Union Gas Limited ("Union") will make a motion to the Ontario Energy Board ("Board") on a date and time to be fixed by the Board.
2. The motion is for a review and variance of the Board's Decision and Order ("Decision") in this matter dated July 31, 2008 for the purpose of clarifying the Decision on the following issues.

Risk Management – 24 Month Fixed-Price Purchase Plan

3. On page 16 of the Decision, the Board states:

"What is at issue, however, is the narrow activity of financial hedging. The other activities, including Union's use of rolling 24 month fixed-price contracts, are in the area of gas supply procurement and are not being considered as part of this issue."

4. Union's rolling 24 month fixed-price purchase plan is financial in nature and does not involve the physical purchase of gas supply. The rolling 24 month fixed-price purchase plan is not part of Union's "gas supply procurement". The rolling 24 month fixed-price purchase plan is facilitated through a financial hedging tool known as a "swap". The Board recognized this in its EB-2005-0520 Decision at para. 2.3.7 when it found:

"It is important to highlight the fact that the 24-month fixed price contracts form part of Union's Risk Management program... Insofar as the Board has approved the Risk Management program and the form of hedging instrument represented by the 24-month fixed price contracts, no further Board approval is needed...."

Like other financial hedging tools within Union's Risk Management program, these swaps contribute to the mark-to-market gains and losses which the Board found, on page 17 of the Decision, to be of no material benefit to consumers.

5. Accordingly, Union seeks clarification and, to the extent the clarification requires, a variance of the Decision to the effect that Union will discontinue all financial commodity risk management activities, including but not limited to, the financial swaps that facilitate the 24-month fixed-price purchase plan.

Risk Management Costs

6. The Board, on page 17 of the Decision, disallowed the recovery of certain costs associated with commodity risk management and directed Union "to record the costs, which are currently embedded in rates" in a deferral account for future disposition at the end of the existing incentive regulation period. The Board also stated that the "appropriate adjustments to distribution rates will be considered at the time of rebasing."
7. Exhibit J10.03 filed in the EB-2005-0520 proceeding explained that the cost of administering Union's Risk Management Program is recovered through the gas supply administration charge. The current Board approved gas supply administration charge contains \$103,831 of costs related to the Risk Management program. There are no costs associated with Union's Risk Management program included in Union's distribution rates.
8. Union assumes that the Board's Decision with respect to the disallowance of costs excludes those costs associated with mark-to-market losses that Union may incur as it discontinues its Risk Management program in a prudent manner. It would be unfair and asymmetrical for Union to be required to absorb risk management losses while ratepayers benefit from risk management gains.

9. Currently, both gains and losses associated with financial hedging (including the 24 month fixed price purchase plan) are taken into account in the Union North and South Purchased Gas Variance Accounts which are recovered/refunded prospectively through the QRAM process. As Union discontinues its Risk Management program, Union will continue to reflect risk management gains and losses in the QRAM process until the termination of that program.
10. Union, therefore, seeks clarification and, to the extent the clarification requires, a variance of the Decision to the effect that:
 - (a) the costs of commodity risk management that the Board disallowed are the costs related to the administration of Union's Risk Management Program of \$103,831; and
 - (b) the elimination of those costs should be accomplished, not by a deferral account to record the elimination of an amount "embedded in rates" but through a reduction in the annual gas supply administration charge of \$103,831. Union proposes, subject to Board approval, to reflect the elimination of \$103,831 for annual risk management administration in its gas supply administration charge beginning with its October 1, 2008 QRAM application.

Tax Change Pass Through

11. At page 9 of the Decision, the Board concluded that 50% of the cost consequences of certain federal and provincial tax changes which become effective during the incentive regulation term (as applied to the tax level reflected in 2007 Board approved rates) should be treated as a Z factor and passed through to customers.
12. In coming to this conclusion the Board indicated that:

"The approach in Exhibit E3.1.1 is indicative of how the savings are to be calculated for purposes of the sharing."
13. Exhibit E3.1.1 was Union's answer to an interrogatory to provide a schedule "similar to that in the Enbridge Gas Distribution Settlement Agreement ... Page 52" ("EGD

Settlement"). Union had no involvement in the negotiation or preparation of the schedule shown on page 52 of the EGD Settlement.

14. Union responded to this interrogatory in accordance with its terms and provided a table similar to the table negotiated in the EGD Settlement. No Union witness adopted Exhibit E3.1.1 as a correct or appropriate basis for calculating a 50/50 sharing of possible tax savings during the incentive regulation term, nor was this suggestion ever put to Union during the hearing. Further, Union made it clear throughout the hearing that the amount of tax savings "shown" in Exhibit E3.1.1 was an assumed, rather than a real, number.
15. Lines 2, 6, 10 and 14 of Exhibit E3.1.1 assume that for each of the years 2008 to 2012, the 2007 Board-approved new rate base additions are added to rate base and, accordingly, reflect the tax change effects consequent on those assumed capital additions.
16. 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.
17. 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.
18. The impact on the amounts shown in the schedule at Exhibit E3.1.1, all else held constant, would be a reduction in the assumed \$80.5 million of tax reductions of about \$15.2 million (i.e., a tax reduction estimate, based on 2007 rate base, of \$4.1 million as opposed to the \$19.27 million shown at line 20 of Exhibit E3.1.1).
19. Union, therefore, seeks clarification of the Decision from the Board that, in saying Exhibit E3.1.1 is "indicative" of how savings are to be calculated for the purposes of sharing, the Board was not directing Union to share 50% of tax "savings" associated with new capital additions during the incentive regulation term (for which no rate increase for cost of capital and taxes will be available).

20. For this motion, Union will rely on the documentary evidence contained in Union's filing in these proceedings and on Rules 42 to 44 of the Board's Rules of Practice and Procedure.

August 28, 2006

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AND TO: All Intervenors



EB-2008-0154

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 amending or varying the rate or rates charged to customers as of July 1, 2008.

AND IN THE MATTER OF an Application by Union Gas Limited for an order or orders amending or varying the rate or rates charged to customers as of July 1, 2007.

AND IN THE MATTER OF Rules 7, 42, 44.01 and 45.01 of the Board's *Rules of Practice and Procedure*.

BEFORE: Cynthia Chaplin
Presiding Member

Paul Vlahos
Member

Paul Sommerville
Member

DECISION ON MOTION

October 23, 2008

Background

Union Gas Limited ("Union") filed an application on March 4, 2008 with the Ontario Energy Board (the "Board") seeking approval for final disposition and recovery of certain 2007 year-end deferral account balances (EB-2008-0034). In that proceeding Union requested, among other matters, disposal of the Long Term Peak Storage Services Deferral Account ("Account 179-72"). Union indicated that, based on its interpretation of the Board's November 7, 2006 Natural Gas Electricity Interface Review Decision ("NGEIR Decision"), it did not record net revenues from long-term storage contracts in Account 179-72 entered into after the NGEIR Decision. On June 3, 2008, the Board issued its decision on the application (the "2007 Deferral Account Decision"). In its decision, the Board rejected Union's interpretation of the NGEIR Decision and ordered Union to include all long-term storage transactions in calculating the balance in Account 179-72, that is, transactions that occurred both before and after the release of the NGEIR Decision.

In its 2006 deferral account application (EB-2007-0598), Union asked the Board to approve a debit charge to Account 179-72. Union claimed that it was required to record a deferred income tax expense of \$10.524 million as a result of the change in the regulatory treatment of storage services provided to Union's ex-franchise customers. Union asserted that the change in accounting treatment resulted from the Board's NGEIR Decision. The Board in its decision on that application (the "2006 Deferral Account Decision") determined that the deregulation of Union's storage assets was notionally equivalent to a divestiture, and that any liabilities associated with these assets should properly be associated with Union's newly formed ex-franchise storage service business. The Board ordered Union to eliminate any and all deferred income tax expense from Account 179-72. The tax expense in question related to the years 1997-2006, the period before the Board's NGEIR Decision.

The Motion

On June 23, 2008, Union filed a Motion to review the Board's 2007 Deferral Account Decision with respect to Account 179-72. In its motion, Union requested a review of the 2007 Deferral Account Decision, on the basis that it is, in Union's view, inconsistent with the NGEIR Decision and the 2006 Deferral Account Decision. Union also requested that if the Board finds that the 2007 Deferral

Account Decision is not inconsistent with the NGEIR Decision, there be a review of the 2006 Deferral Account Decision, on the basis that it is, in Union's view, inconsistent with the 2007 Deferral Account Decision.

Union claimed that the inconsistency between the two deferral account decisions leaves Union with contradictory directions from the Board as to how it is to calculate the margins that are to be shared with ratepayers during the phase-out period. Union claimed that it would be unfair to require Union to share with ratepayers the margins earned from its unregulated Post-NGEIR Long-Term Storage Contracts while at the same time prohibiting Union from deducting from Account 179-72 all the costs of providing that unregulated service.

The Board issued a Notice of Hearing and Procedural Order No. 1 on July 14, 2008, setting out the timelines for intervenor submissions and Union's reply submission on both the threshold question and the substantive issues. In addition to Board staff, the following intervenors filed submissions:

- Canadian Manufacturers & Exporters ("CME")
- School Energy Coalition ("SEC")
- City of Kitchener
- London Property Management Association ("LPMA")
- Industrial Gas Users Association ("IGUA")

Intervenors and Board staff submitted that the Board should reject Union's motion.

For the reasons set out below, the Board rejects Union's motion.

The Threshold Question

Part VII (sections 42 to 45) of the Board's Rules of Practice and Procedure deals with the review of decisions of the Board. Rule 42.01 provides that "any person may bring a motion requesting the Board to review all of or part of a final order or decision, and to vary, suspend or cancel the order or decision". Rule 42.03 requires that the notice of motion under Rule 42.01 shall include the information required under Rule 44. Rule 44.01 provides as follows:

44.01 Every notice of motion made under Rule 42.01, in addition to the requirements under Rule 8.02, shall:

- (a) set out the grounds for the motion that raise a question as to the correctness of the order or decision, which grounds may include:
 - (i) error in fact;
 - (ii) change in circumstances;
 - (iii) new facts that have arisen;
 - (iv) facts that were not previously placed in evidence in the proceeding and could not have been discovered by reasonable diligence at the time; and
- (b) if required, and subject to Rule 42, request a stay of the implementation of the order or decision or any part pending the determination of the motion.

Under Rule 45.01 the Board may determine whether the motion properly supports a request for review and variance of the Board's decision. Rule 45.01 allows the Board to dismiss a motion without holding a hearing if the Board determines that a motion does not meet the threshold.

The threshold test for a motion to review was recently articulated in the Board's May 22, 2007 decision respecting a motion to review the NGEIR Decision.¹ In that motion decision the Board stated:

In determining the appropriate threshold test pursuant to Rule 45.01, it is useful to look at the wording of Rule 44. Rule 44.01(a) provides that:

Every notice of motion... shall set out the grounds for the motion that raise a question as to the correctness of the order or decision...

Therefore, the grounds must "raise a question as to the correctness of the order or decision". In the panel's view, the purpose of the threshold test is to determine whether the grounds raise such a question. This panel must also decide whether there is enough substance to the issues raised such that a review based on those issues could result in the Board deciding that the decision should be varied, cancelled or suspended.

With respect to the question of the correctness of the decision, the Board agrees with the parties who argued that there must be an identifiable error in the decision and that a review is not an opportunity for a party to reargue the case. In demonstrating that there is an error, the applicant must be able to show that the findings are contrary to the evidence that was before the panel,

¹ NGEIR (EB-2006-0322, EB-2006-0338, EB-2006-0340) Motions to Review, the Natural Gas Electricity Interface Review Decision, Decision with Reasons, May 22, 2007, pp. 17-18.

that the panel failed to address a material issue, that the panel made inconsistent findings, or something of a similar nature. It is not enough to argue that conflicting evidence should have been interpreted differently.

The applicant must also be able to demonstrate that the alleged error is material and relevant to the outcome of the decision, and that if the error is corrected, the reviewing panel would change the outcome of the decision.

In the Board's view, a motion to review cannot succeed in varying the outcome of the decision if the moving party cannot satisfy these tests, and in that case, there would be no useful purpose in proceeding with the motion to review.

In demonstrating that there are grounds for questioning the correctness of the 2006 and 2007 Deferral Account Decisions, it is the Board's view that Union must be able to show that the findings are contrary to the evidence that was before the panel, that the panel failed to address a material issue, that the panel made inconsistent findings, or something of a similar nature.

The 2007 Deferral Account Decision and the NGEIR Decision

As noted by intervenors and Board staff, the 2007 Deferral Account Decision essentially reiterates the NGEIR Decision. The Board's findings on page 106 and 107 of the NGEIR Decision clearly outline the Board's approach to the sharing of long-term margins. After initially describing a conceptual approach of sharing margins on existing long-term contracts separately from margins on post-NGEIR long-term contracts, the Board decided against implementing the conceptual approach in favour of a simpler approach. The Board cited complexity and the requirement for an ongoing review as the primary reasons for not selecting the conceptual approach.

The Board determined that it would adopt a simpler phase-out mechanism as "a rough sort of 'proxy'". This "proxy" approach is the four-year phase out of the margin sharing. The Board stated,

The Board considered whether to require Union to record the margins on existing long-term contracts separately from the margins on new long-term contracts. Under this approach, ratepayers would be credited with 90% of the margins on existing contracts for the remaining term of those contracts. This approach conceptually has appeal but could give rise to ongoing implementation questions. For example, the Board might have to consider how contract re-negotiations or defaults by customers are to be treated. This level of complexity and potential ongoing review is unwarranted.

The Board has concluded that it should adopt a simpler phase-out mechanism that is a rough sort of "proxy" for the conceptual approach described above. The phase-out of the sharing of margins on Union's long-term storage transactions will take place over four years. The share accruing to Union will increase over that period to recognize that contracts will mature and a larger part of Union's total long-term margins will be generated by new transactions. For 2007, forecast margins (on long-term and short-term transactions) now included in the determination of rates will remain unchanged. After 2007, Union's share of long-term margins will be as follows: 2008 – 25%, 2009 – 50%, 2010 – 75%, 2011 and thereafter – 100%.

Union's interpretation of the NGEIR Decision is that, during the phase-out period, it is only required to share with ratepayers the long-term margins arising from the pre-NGEIR long-term storage contracts, and that it can retain all of the margins earned from all post-NGEIR long-term storage contracts. In the NGEIR Decision the Board clearly explained the way in which the "proxy" approach is roughly equivalent to the conceptual approach. The Board stated: "The share accruing to Union will increase over that period to recognize that contracts will mature and a larger part of Union's total long-term margins will be generated by new transactions." Therefore it is clear that Union's interpretation of the NGEIR Decision is incorrect; the Board clearly contemplated a transition during which Union's share of the storage margins would increase in recognition that more of the total storage margins would be attributable to new contracts.

For these reasons the Board finds that the 2007 Deferral Account Decision was correct and there is no inconsistency between the 2007 Deferral Account Decision and the NGEIR Decision.

The 2007 Deferral Account Decision and the 2006 Deferral Account Decision

Union claimed that the finding in the 2006 Deferral Account Decision that all costs associated with Union's unregulated storage business should not be applied to Deferral Account 179-72 is inconsistent with the finding in the 2007 Deferral Decision that "net revenues" from the unregulated storage business should be applied to Deferral Account 179-72 during the four year phase-out period. Union argued that in order to calculate "net revenues" from the unregulated storage business Union must be able to deduct the costs associated with the unregulated storage business, but the 2006 Deferral Account Decision prohibits Union from doing so.

In the 2006 Deferral Account Decision, the Board stated at page 8:

The Board notes that while accounting treatment can be an important consideration in the regulatory treatment of matters, it is not always predictive of the regulatory outcome. The fact that Union may have to change its accounting treatment of the deferred tax account as a result of the NGEIR decision, does not automatically lead to the conclusion that the accounting tax liability associated with it should come into rates now, or at all. In the absence of a near certain revenue stream that matches future costs, a company must book the future liability. Regulated entities have the assurance that prudently incurred costs will be offset by regulated revenues and therefore they need not book the future liability. In these circumstances, this rule has limited relevance for how the change may be reflected from a regulatory point of view.

The respective accounting treatments for regulated and non-regulated entities reflect the distinction of one entity having a predictable revenue stream where as the other does not. Furthermore, the CICA handbook does not consider the disposition of the historic costs or who bears them in a regulatory context. This remains the purview of the regulator.

The Board finds that the deregulation of Union's storage assets is notionally equivalent to a divestiture, and that any liabilities associated with these assets should properly be associated with Union's newly formed ex-franchise storage service business.

The Board in the 2006 Deferral Account Decision determined that deferred taxes for the period 1997 to 2006 were not recoverable from ratepayers regardless of the accounting implications of the deregulation of the ex-franchise storage business. Union had recorded a deferred tax liability of \$10.524 million related to the unregulated storage operations related to the period 1997-2006, which preceded the NGEIR Decision. This liability represented the portion of Union's unrecorded future income taxes from 1997 to 2006 related to the ex-franchise storage operations using the percentage of unregulated storage established in the NGEIR Decision. In denying the recovery of the deferred tax expense, the Board determined that all liabilities associated with Union's unregulated portion of storage assets should be associated with those assets. This was a distinct issue that dealt with historical deferred taxes and the recovery of that liability by Union. This is the only aspect of deferred taxes addressed by the Board in that decision.

Union's argument that net storage contract revenues cannot be determined without reference to deferred tax costs to provide the services associated with those revenues is, from a regulatory perspective, incorrect. It is within the purview of the regulator to determine whether such costs can be recovered or included in rates notwithstanding potential accounting requirements. The 2006 Deferral Account Decision determined that the deferred tax liability related to 1997-2006 should not be recoverable from a regulatory perspective.

Notably, in the 2007 Deferral Account proceeding, Union did not indicate that it was not recording post-NGEIR long-term storage transactions in Account 179-72. This was despite the fact that this was a significant change in how the balances were calculated. This change was revealed in Union's reply argument in response to Board staff's submission on this issue. Union's reply argument in that proceeding makes no mention of deferred taxes or the 2006 Deferral Account Decision. If the 2006 Deferral Account Decision had relevance to the position Union was advancing, then Union should have raised that argument in the 2007 Deferral Account proceeding. As a result, the 2007 Deferral Account Decision does not address in any way the impact of deferred taxes on the 2007 net revenues from ex-franchise storage transactions.

Union's argument that it is unable to comply with both the 2006 Deferral Account Decision and the 2007 Deferral Account Decision at the same time is not convincing.

Union can include ongoing costs associated with the unregulated storage business to calculate net revenues with the exception of deferred taxes for the period 1997-2006, the liability which was at issue in the 2006 Deferral Account Decision and for which the Board denied recovery. The 2006 Deferral Account Decision makes no finding as to the appropriate recognition of taxes in the determination of net revenues from storage transactions for the period 2007 and beyond; the decision deals specifically and exclusively with the 1997-2006 deferred tax expense. And, as indicated above, the issue of deferred taxes was not raised at all in the 2007 proceeding, and therefore the 2007 Deferral Account Decision also does not address the treatment of taxes for purposes of determining "net revenues" from ex-franchise storage services. The 2007 Deferral Account Decision accepted the \$2.196 million that was included in

Union's application but directed Union to recalculate the 2007 balance in account 179-72 in accordance with the Board's finding, for later disposition. There is nothing in that decision to prevent Union from including current and deferred tax expenses related directly to the 2007 revenues as a cost for purposes of determining net revenues.

Therefore, there is no basis upon which to conclude that the 2006 Deferral Account Decision is inconsistent with the 2007 Deferral Account Decision or the NGEIR Decision.

Conclusion

In conclusion, Union has failed to demonstrate that the findings made by the panels in the 2006 and 2007 Deferral Account Decisions are contrary to the evidence that was before the panels, or that the panels failed to address a material issue or that the panels made inconsistent findings.

The Board therefore dismisses Union's motion for review on the grounds that it fails to pass the threshold test for review. Even if the Board found that the threshold test had been met, and determined that it was appropriate to review the 2006 and 2007 Deferral Account Decisions, the Board would find that the 2006 and 2007 Deferral Account Decisions were correct for the reasons set out throughout this decision.

In light of the decision the Board has made on the threshold question, it is unnecessary to address the issue of the timeliness of Union's request for a review of the 2006 Deferral Account Decision.

A cost awards decision will be issued after the steps set out below are completed. The Board notes that if Union had been successful in these reviews, only its shareholder would have benefited. Accordingly, and because the review failed at the threshold test, the Board asks parties when submitting their respective costs claims to address the question as to how the costs associated with these reviews should be accounted for. Union can respond to any proposals on this question, when it responds to the costs claims.

1. Intervenors eligible for cost awards shall file with the Board and forward to Union their respective cost claims within 15 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 30 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 45 days of the date of this Decision.

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

DATED at Toronto, October 23, 2008

ONTARIO ENERGY BOARD

Original Signed By

Cynthia Chaplin
Presiding Member

Original Signed By

Paul Vlahos
Member

Original Signed By

Paul Sommerville
Member