

Excerpts from EB 2007-0606/0615
DECISION

Exhibit K.1.1.

Nov 10/08

Ontario Energy Board	
FILE No.	EB-2008-0292
EXHIBIT No.	K1.1
DATE	Nov 10/08
08/99	

EB-2008-0292 - Hearing Date
Nov 10/08.

DECISION

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.

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 the 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. V

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

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

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

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

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

MR. BIRMINGHAM: Yes, sir.

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

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

MR. THOMPSON: It's an item that is beyond the control of the utility; would you agree?

MR. BIRMINGHAM: Absolutely.

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

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

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

MR. BIRMINGHAM: I'm not following that question, Mr.

I

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.		(\$ millions)				
		2008	2009	2010	2011	2012
		(a)	(b)	(c)	(d)	(e)
Tax Related Amounts Forecast from CCA Rate Changes						
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
21	Incremental Amount	2.39	1.01	0.71	0.44	0.29
						<u>19.27</u>
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
31	Incremental Amount	4.09	0.74	1.46	2.11	2.02
						<u>34.05</u>
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
39	Incremental Amount	1.81	-	4.53	2.27	-
						<u>27.19</u>
40	Cumulative Total Forecast Tax Related Amount (lines 20+30+38)	<u>8.29</u>	<u>10.05</u>	<u>16.75</u>	<u>21.56</u>	<u>23.86</u>
						<u>80.51</u>

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 $(0.150\% + 0.0\%) \times 0.5 = 0.075\%$.