uniongas
A Spectra Energy Company

December 19, 2008

Ontario Energy Board
2300 Yonge Street
Suite 2700
Toronto, Ontario
M4P 1E4

Attention: Ms. Kirsten Walli, Board Secretary

Re: EB-2008-0220 - 2009 Rates - Effective January 1, 2009
Union's Argument in Chief.

Dear Ms. Walli:

Please find attached Union's Argument in Chief in the above noted proceeding.

Yours truly,

[original signed by]

Chris Ripley
Manager, Regulatory Applications

cc: EB-2008-0220 Intervenors
M. Penny (Torys)

EB-2008-0220

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an Application by Union Gas Limited, pursuant to section 36(1) of the *Ontario Energy Board Act*, 1998, for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas as of January 1, 2009.

ARGUMENT IN CHIEF OF UNION GAS LIMITED

1. The Board-approved settlement of Union's rate application in EB-2007-0606 established a multi-year incentive rate making (IR) mechanism for the determination of rates from 2008 to 2012. Union's IR mechanism uses a price cap index (PCI) model that is structured as PCI = I-X+Z+Y+AU, where I is the inflation factor, X is the productivity factor, Z represents certain non-routine adjustments, Y represents certain predetermined pass-throughs and AU is an adjustment for changes in the average use of gas.

2009 Inflation Factor and Productivity Factor

2. The approved settlement provides for an IR mechanism which employs an inflation factor based on the actual year over year change in the annualized average of four quarters (using Q2 to Q2) of Statistics Canada's Gross Domestic Product Implicit Price Index Final Domestic Demand (Settlement Agreement, para. 2.1.1, p. 10).

3. Employing these parameters, the 2009 inflation factor is 1.54% (Working Papers, Schedule 1, p. 1).

4. The approved productivity factor is 1.82% (Settlement Agreement, para. 3.1, p. 12).

5. When the productivity factor of 1.82% is applied to the inflation factor of 1.54%, the result is a net reduction of 0.28% for 2009. Inflation less productivity alone, therefore, results in a decrease of $1.923 million to infranchise rates and a decrease of $0.523

million to regulated exfranchise rates (Exhibit A, T1, p. 2; Working Papers Schedule 1, p. 2).

Z Factor Adjustments

6. Union is proposing Z factor adjustments for two matters in 2009: 1) the cost consequences associated with changes in taxation levels, as determined by the Board in EB-2008-0292; and 2) the cost consequences of adopting International Financial Reporting Standards ("IFRS").

7. The approved criteria for Z Factors are:

   (i) the event must be causally related to an increase/decrease in cost;

   (ii) the cost must be beyond the control of the utility's management and not a risk for which a prudent utility would take risk mitigation steps;

   (iii) the cost increase/decrease must not otherwise be reflected in the PCI;

   (iv) any cost increase must be prudently incurred; and

   (v) the cost increase/decrease must meet the materiality threshold of $1.5 million annually per Z factor event (i.e., the sum of all individual items underlying the Z factor event) (Settlement Agreement, para. 6.1, p. 17).

(a) Tax Changes

8. The treatment of tax changes during Union's IR plan was considered by the OEB in a decision of July 31, 2008 in EB-2007-0606, and clarified in the Board's December 10, 2008 Decision on Union's motion for review in EB-2008-0292.

9. The approved settlement provided that Union's 2008 rates would include an interim decrease of $8 million to reflect the approximate level of federal and provincial tax changes for 2008. This was an interim position pending the outcome of the Board's decision on the treatment of tax changes during the IR term (Settlement Agreement, Addendum, paras. 5 and 6, pp. 2-3).

10. Union established a deferral account (No. 179-119) to capture the variance between the interim adjustment made to 2008 rates and any adjustment resulting from the Board's decision on the treatment of tax changes.

11. The Board's July 31, 2008 decision determined that, during the IR term, 50% of the tax reduction should be treated as a Z factor. The Board's decision also determined that 50% of the impact arising from the 2007 tax reductions should also be subject to Z factor treatment.

12. The Board's December 10, 2008 Decision determined that the tax changes subject to Z factor treatment to be shared 50/50 extended to tax changes associated with capital additions made during the term of the IR plan. The Board further determined that the capital additions for computer equipment and distribution assets reflected in Union's 2007 rates should be used to calculate, in each year of the IR term, the shared tax savings arising from the increased capital cost allowances associated with these capital additions. The calculation of the 50% tax sharing, based on the Board's clarification in EB-2008-0292, is set out at Exhibit B5.4.

13. 50% of the cumulative tax savings for 2008 (relative to the tax amounts included in 2007 Board approved rates) is $4.146 million (Exhibit B5.4, Attachment 1, column (a) line 17). The difference between $4.146 million and the interim adjustment of $8 million is $3.854 million (Exhibit B5.4, Attachment 1, column (a), line 19). This difference will be captured in deferral account 179-119 and disposed of in the 2008 deferral disposition proceeding.

14. The deferral account, however, only addresses the impacts in 2008 of the difference between the interim adjustment and the Board's decisions on the tax issue. To recognize the Board's Decision and update 2009 rates, the $8.000 million "tax saving" must be removed from rates and replaced with $5.026 million (Exhibit B5.4, Attachment 1, column (b), line 17) for a net rate increase of $2.974 million.

15. Union proposes to adjust rates as outlined at Working Papers Schedule 4, updated for the Board's December 10, 2008 Decision.

(b) International Financial Reporting Standards

16. Union is proposing a Z factor adjustment, effective January 1, 2009, to cover costs associated with converting from Canadian generally accepted accounting principles to IFRS.

17. The conversion to IFRS is the result of the Canadian Accounting Standards Board requirement that all publicly accountable enterprises adopt IFRS for interim and annual reporting purposes beginning January 1, 2011. Union, because it issues debt in the public markets, is a publicly accountable enterprise and must comply with these accounting changes.

18. Because publicly accountable enterprises are also required to report prior year financial statements for comparative purposes under IFRS, Union must complete the required system and reporting changes by early 2010 in order to be able to prepare IFRS compliant financial statements for 2010.

19. Union estimates that the conversion to IFRS will cost $5.177 million pre-tax between 2008 and 2012.

20. The conversion to IFRS meets the criteria established for Z factor treatment. The increased costs are a direct result of the requirement to convert Union's accounting systems. Further, the conversion to IFRS is required by the Canadian Accounting Standards Board. Accordingly, the required change in accounting standards is beyond management's control and is not a risk which a prudent utility could have mitigated. Changes to accounting standards are, and have always been, a classic example of a change in costs warranting Z factor treatment. The Board's Decision in RP-1999-0017 specifically mentioned changes in generally accepted accounting principles as a change for which Z factor treatment was appropriate. In EB-2007-0606, Union's evidence, in providing examples of Z factor events, also specifically mentioned changes in cost associated with changes to generally accepted accounting principles (EB-2007-0606, Exhibit B, T1, p. 40).

21. There is no reason to think the costs associated with conversion to IFRS are otherwise captured in the price cap index. Not all enterprises need incur these conversion costs - only those which are publicly accountable. Over 100 countries, including those of the European Union, Australia and New Zealand have already adopted IFRS and, therefore, will not be incurring conversion costs. This is relevant because Canada is a small trading nation with an open economy. Further, new entrants to the world of publicly accountable enterprises will design their accounting policies and internal controls to be compliant with the new standards from the outset and will also, therefore, incur no conversion costs.

22. The costs being incurred are prudent. Union has sought to minimize the conversion costs. In doing so, it has worked with other Canadian divisions within Spectra Energy to share resources and information so as to avoid duplicating effort and cost. Union is also using internal resources to limit outside consulting costs (Exhibit A, T1, p. 8).

23. Union has completed its design of the conversion project and has determined that the total projected costs will be approximately $5.2 million, pre-tax. Pre-tax costs are the relevant costs for the purposes of measuring the monetary threshold of $1.5 million (EB-2007-0606, Exhibit C3/C16/C33.25).

24. Union views the IFRS costs as a one time event and proposes to adjust rates annually over the IR term, given that the costs associated with the IFRS conversion are largely incurred in 2009 and 2010. Because a large proportion of those costs are capital costs associated with changes to Union's accounting system, there will be revenue requirement impacts beyond those years (depreciation, return, tax). Accordingly, the costs in 2011 and 2012 are directly relating to capital costs incurred in 2009 and 2010. They are part of the same Z factor event and cannot be viewed on a standalone basis (Exhibit A, T1, p. 6, Table 1; Exhibit B2.1(c)).

25. Union recognizes that 2008 costs are prior period costs that cannot be recovered retroactively through a Z factor. However, it is Union's position that the balance of IFRS costs, i.e., $4.209 million, are recoverable as a Z factor as set out at Table 1 of Exhibit A, T1, p. 6.

26. Apart from the $868,000 of costs in 2008, therefore, Union is proposing to make the Z factor adjustments from 2009 to 2012 as outlined in Exhibit A, T1, p. 9, Table 2.

Y Factor Adjustments

27. The approved settlement specified the items that would not be adjusted by the price cap index but, rather, passed through into rates as Y factors. These were:

- upstream gas costs
- upstream transportation costs
- incremental DSM costs (as determined in EB-2006-0021 and in any subsequent DSM proceeding) and volume reductions
- storage margin sharing changes (as determined in EB-2005-0051).

28. It was also agreed that the deferral accounts listed in Appendix B to the Settlement Agreement, including the LRAM and SSM, would continue during the incentive regulation plan.

29. It is Union's position that amounts recorded as upstream transportation and gas costs have been and will continue to be determined using the Board approved QRAM methodology.

30. As determined in EB-2006-0021, Union has increased 2008 DSM program costs by 10% or $1.87 million. This increase brings the total 2009 DSM program costs to $20.57 million. These costs have been allocated in the same manner as DSM costs were allocated in Union's 2007 rate case. The detailed allocations are set out in the Working Papers Schedule 4.

31. Union was directed in EB-2005-0551 to phase out the sharing of margins on Union's long-term storage transactions over four years, starting in 2008, such that by 2011, 100% of the margin from long-term storage transactions will be removed from rates. For 2009, therefore, Union has reduced the infranchise rate payer share of long-term storage

margins from 75% to 50%, with a resulting increase of $5.351 million to infranchise rates. The detailed calculation is at Schedule 14 of the pre-filed evidence.

Average Use Factor

32. In the approved settlement, it was agreed that delivery rates would be adjusted during the IR term to reflect the impact of changes in average use per general service customer on a rate class by class basis, for rates M1, M2, 01 and 10. The formula for calculation of the average use factor is to reduce the volume used to determine rates by the average of the most recent three years' actual weather normalized volume loss per general service customer within each of the four rate classes (using the 55/45 blended weather method, updated annually). On December 18, 2008, Union discovered an error in its pre-filed calculations of the 2009 average use factor. A revised Exhibit B5.2 and Schedule 10 were filed on December 18, 2008, correcting the error. The corrections result in a rate increase of approximately $0.500 million to the General Service rate classes. For the average residential customer consuming 2,600 m^3, the bill impact of this correction is $0.23 per year. For Rates M1 and M2, the average use factor is a reduction of 0.5%. For Rate 01, the average use factor is a reduction of 0.8% and, for Rate 10, the average use factor is an increase of 1.3%.

Annual Adjustment to General Service Monthly Charges

33. The approved settlement provided for an increase in the fixed monthly charge in the M1 and Rate 01 rate classes of $1 in each year of the five year IR term. Accordingly, the fixed monthly charge in the M1 and Rate 01 rate classes will be $18 in 2009. This is being done, as agreed, on a revenue neutral basis, such that the $1 increase in fixed monthly charges results in a decrease in the volumetric delivery charges. The calculation of the revenue neutral offset appears in Schedule 4 of the prefiled evidence.

Other Rate Schedule Changes

34. Union is also proposing to amend the rate schedules, with respect to late payments, to show the effective annual interest rate (of 19.56%) which results from Union's Board approved monthly late payment charge of 1.5%. This is purely for informational and transparency purposes and has no impact on rates.

35. Union is also proposing to add the Dawn-Tecumseh Sombra line extension receipt and delivery point to the C1 Rate Schedule to recognize the interconnect between Union's Dawn Storage Facility and Enbridge's Tecumseh Storage operations. Again, there is no rate impact on any rate classes as a result of this change.

Customer Impacts

36. The impact of all these changes represents an increase of between 0.4% to 0.6% of the total annual residential bill. Schedule 8 of the Working Papers provides average 2009 unit price changes for all the infranchise rate classes and Schedule 9 provides customer bill impacts for general service rate classes.

Recovery of Rate Changes from January 1, 2009

37. Union filed its application and a draft rate order with supporting documentation on September 28, 2008, before the October 31 date required by the approved settlement. Union applied for an order making its rates interim effective January 1, 2009. The necessity for this step arose because it became clear, following the issuance of the Board's Procedural Order No. 1 on November 28, 2008, that a rate order determining 2009 rates under the IR mechanism by December 15, 2008 (as contemplated by the approved settlement) was not possible. By order dated December 16, 2008, the Board granted Union's request and made Union's rates interim effective January 1, 2009.

38. Union proposes to implement the Board approved final rates for 2009 on the first billing cycle on or after April 1, 2009. Variances between interim rates charged to customers during the period January 1, 2009 and March 31, 2009 and the final rates approved by the Board shall form part of an adjustment amount to be recovered from each rate class at the time final 2009 rates are implemented.

Conclusion

39. In conclusion, Union asks the Board to issue a rate order effective January 1, 2009 to reflect these changes in rates.

December 19, 2008

Torys LLP
Suite 3000
79 Wellington St. W.
Box 270, TD Centre
Toronto, Ontario
M5K 1N2 Canada

Michael Penny LSUC#: 23837N
Tel: 416.865.7526

Counsel for the Moving Party,
Union Gas Limited

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

Tel: 416.481.1967
Fax: 416.440.765

AND TO: All Intervenors