

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.

SUBMISSIONS OF
THE LONDON PROPERTY MANAGEMENT ASSOCIATION

The London Property Management Association (“LPMA”) has reviewed the various components of the 2009 Incentive Rate Making application from Union Gas (“Union”) and provides the following submissions on these components.

A) 2009 Inflation Factor and Productivity Factor

LPMA has reviewed the calculations used in determining the 2009 inflation factor and believes that Union has correctly calculated to the inflation factor to be 1.54%. Moreover, Union has properly applied the net adjustment of the inflation factor less the productivity factor of 1.82% as shown in the Working Papers.

B) Z Factors

Union has applied for two Z factors: tax changes and International Financial Reporting Standards.

i) Tax Changes

Union had not fully incorporated the impact of tax changes resulting from the Board’s EB-2007-0606 Decision of July 31, 2008 and the subsequent clarification in the Board’s December 10, 2008 Decision on Union’s motion for review in EB-2008-0292 in their pre-filed evidence.

In their Argument in Chief, Union has proposed that they will adjust rates as outlined in the Working Papers at Schedule 4 to reflect the Board's December 10, 2008 Decision. LPMA supports this proposal both in terms of the allocation of the shown in Schedule 13 of the Working Papers and in terms of the amount of the Z factor associated with the tax changes. This amount and calculation is shown in the response to an LPMA interrogatory at Exhibit B5.4. In particular, LPMA agrees with the calculation of the cumulative total tax related amount reflected in rates shown at line 17, column (b) of Exhibit B5.4 of \$5,026. This amount accurately reflects 50% of the amount calculated in Exhibit E3.1.1 from the EB-2007-0606 proceeding. Moreover, LPMA agrees with the subsequent impact of \$2,974 shown on line 19 of Exhibit B5.4 as being appropriate.

ii) International Financial Reporting Standards

Union is proposing a Z factor adjustment that would be effective January 1, 2009 to cover costs associated with converting from Canadian generally accepted accounting principles to IFRS. Union has estimated the costs for this conversion over the 2008 through 2012 period to be \$5.177 million on a pre-tax basis. Union states in its Argument-in-Chief that it views the IFRS costs as a one-time event and proposes to adjust rates annually over the remainder of the IR term.

Union further indicates that the IFRS conversion costs are largely incurred in 2009 and 2010, but that because a large proportion of the costs are capital costs, there are revenue requirement impacts in 2011 and 2012 that are directly related to the costs incurred in 2009 and 2010. Union also indicates that the costs it incurred in 2008 are prior period costs that cannot be recovered through a Z factor. Union's position is that the balance of the IFRS costs that total \$4.209 million over the 2009 through 2012 period are recoverable as a Z factor as set out in Table 1 of Exhibit A, Tab 1, at page 6. The resulting revenue requirement of the IFRS conversion costs over this period totals \$4.310 million as shown in Table 2 of Exhibit A, Tab 1, at page 9. Union is requesting that the Board approve a four year recovery of these costs through a single Z factor adjustment.

a) The Threshold Question

LPMA submits that the threshold question is whether or not the IFRS conversion cost qualify as a Z factor adjustment. The approved criteria for Z factors are set out at paragraph 7 of Union's Argument-in-Chief.

LPMA does not take issue with the first four criteria. However, the fifth criterion requires further examination. Specifically, this criterion states that the cost increase/decrease must meet the materiality threshold of \$1.5 million annually per Z factor event. Union has already indicated that it believes the conversion to IFRS is a one time Z factor event. However, the costs that will be incurred are spread out over a number of years. In particular, Union is requesting approval of a Z factor that would be in place for the remaining four years of the IRM plan, 2009 through 2012. The total pre-tax of the IFRS conversion, as noted above and in Table 1 of Union's evidence is \$4.209 million, or just over \$1.0 million on an annual basis. LPMA submits that the Board should consider whether this annual average cost meets the "materiality threshold of \$1.5 million annually". LPMA submits that the costs forecast by Union do not meet this materiality threshold and the proposed Z factor adjustment should be disallowed.

b) The Subsequent Question

If the Board determines that at least some of the IFRS conversion costs meet the materiality threshold because the costs in aggregate over the 2009 through 2012 period exceed \$1.5 million, then LPMA submits that the subsequent question is whether or not Union should be allowed to recover these costs in each of 2009, 2010, 2011 and 2012.

While the IFRS conversion costs (pre-tax) are forecast to exceed \$1.5 million in each of 2009 and 2010, they do not come close to this figure in either 2011 or 2012. The question then arises that if Union is allowed to recover the costs in 2009 and 2010 because they exceed the materiality threshold of \$1.5 million annually in each of 2009 and 2010, should they be allowed to recover costs that do not meet the annual materiality threshold in either of 2011 or 2012? Again, LPMA submits that the Board should

disallow the claimed Z factor costs forecast for 2011 and 2012 on the grounds that they do not meet the materiality threshold.

c) The Follow-Up Question

If the Board allows the recovery of the forecasted 2009 and 2010 IFRS related conversion costs because they exceed the materiality threshold of \$1.5 million in each of those specific years, then the Board should request further explanation from Union for one of the major costs that it is forecasting to incur in both of those years to determine if the materiality threshold is indeed being exceeded.

The response to an LPMA interrogatory, found at Exhibit B5.1, part (h), shows that in 2009 and 2010, the projected costs that are shared between Union and Westcoast total \$444,000 in 2009 and \$157,500 in 2010. The response also indicates that these costs are shared equally between Union and Westcoast, resulting in \$222,000 and \$78,800 being included in the IFRS related conversion costs for Union in 2009 and 2010, respectively.

Apparently the 50/50 allocation is based on the premise that Union Gas and Westcoast are the only two Spectra “publicly accountable” enterprises in Canada. Only publicly accountable enterprises are required to convert to IFRS. However, Westcoast has many other companies in Canada. While these other corporations may not be required to convert to IFRS, it is highly likely that they will convert since their financial results, like that of Union Gas, ultimately need to be reported by the parent, Westcoast, under the IFRS standards. If these companies benefit from the knowledge and conversion of Westcoast and Union Gas, they should be allocated a portion of these shared costs.

It should be noted that in 2009, a reduction of only \$12,000 would put Union below the materiality threshold. If Union were to be allocated 47% of the shared costs in 2009 rather than 50%, this would be a reduction in the shared costs allocated to Union of \$13,000 and they would not longer meet the materiality threshold. Similarly, in 2010, a reduction of only \$11,000 would put Union below the materiality threshold. A reduction in the allocated of shared costs from 50% to 43% would result in this reduction.

In its Argument-in-Chief, Union states at paragraph 27, that it has worked with other Canadian divisions within Spectra Energy to share resources and information so as to avoid duplicating effort and cost. This implies that more than just Westcoast is benefiting from this shared arrangement and that Union Gas is paying more than an appropriate share of these costs.

LPMA submits that the Board should require more information from Union as to why the Board should implicitly approve a 50/50 sharing of the shared costs between Union and Westcoast before approving the Z factor adjustments for 2009 and/or 2010.

d) Adjustment to Eliminate 2008 Cost Impacts

If the Board determines that all or a portion of the IFRS conversion costs qualify as a Z factor, then LPMA submits that the costs related to the 2008 expenses incurred by Union should be removed from their calculation of the pre-tax costs shown in Table 1 of Union's evidence.

In their Argument in Chief, Union states at paragraph 25 that:

"Union recognizes that 2008 costs are prior period costs that cannot be recovered retroactively through a Z factor."

However, Union is claiming the costs associated with the capital expenditures made in 2008 in 2009 through 2012. These costs are related to the depreciation and interest expenses claimed by Union in 2009 through 2012.

The depreciation expense claimed in each of 2009 through 2012 includes a component related to the 2008 capital investment. As shown in Exhibit B5.1, part (b) (Corrected), 2009 through 2011 include a depreciation expense of \$148,000 with another \$74,000 forecast for 2012. It should be noted that this depreciation expense is based on a capital expenditure of \$592,000 in 2008. As shown in the response in Exhibit B5.1, part (k), the updated investment forecast for 2008 is \$932,000. Part (c) of the response in Exhibit B5.1 also shows that the interest expense included in the forecasted costs includes a rate base calculation that includes the original forecast of \$592,000 in 2008. In other words,

Union is claiming both the depreciation expense and the interest cost in 2009 through 2012 associated with the 2008 capital investment. LPMA submits that they should not be allowed to recover the costs associated with investment before the establishment of the Z factor in 2009.

LPMA has updated the depreciation and interest expense calculations found in Exhibit B5.1 to reflect both the removal of the cost impacts associated with the 2008 capital expenditures and the fact that Union has exceeded their forecast for both capital investment and O&M for 2009. As shown in the response to part (k) of Exhibit B5.1, Union has an updated capital expenditure figure for 2008 of \$932,000 as compared to a forecast of only \$592,000 and Union also has spent O&M in the amount of \$907,000, as compared to the forecast of \$882,000. More importantly, however, Union indicates at the end of that response that these variances are related to the timing of the actual expenditures relative to the project plan. In other words, the total O&M and capital expenditure budgets are still accurate, only the timing of the expenditures has changed. In the following analysis, LPMA has reduced the 2009 O&M and capital expenditure figures to reflect the higher expenditures that took place in 2008. The overall plan expenditures have not been changed.

The following table shows the calculation of the depreciation expense that will be incurred in 2009 through 2012 based on removing the 2008 capital expenditures and reducing the 2009 expenditures to reflect the movement of additional capital to 2008, with no change in the total capital expenditures. This table is presented in the same format as the response to Exhibit B5.1, part (b) Corrected.

Depreciation Expense

Year of Investment	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>Total</u>
Capital Investment	0	994	263	1,257
2009	0	124		124
2010	0	249	33	281
2011	0	249	66	314
2012	0	249	66	314

The following table shows the calculation of the interest expense, again reflecting the removal of the 2008 capital expenditure impact on rate base and the lowering of the 2009 capital expenditure to reflect the additional spending that was shifted to 2008. This table is presented in the same format as the response to Exhibit B5.1, part (c).

Interest Expense

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Opening Balance	0	0	994	1,257	1,257
Additions	<u>0</u>	<u>994</u>	<u>263</u>	<u>0</u>	<u>0</u>
Closing Balance	0	994	1,257	1,257	1,257
Accumulated Depreciation	0	124	406	720	1,034
NBV	0	870	851	537	223
Rate Base (average)	0	435	861	694	380
Interest Rate	4.71%	4.71%	4.71%	4.71%	4.71%
Interest Expense	0	20	41	33	18

The following table, which would replace Table 1 in Union's evidence at Exhibit A, Tab 1, reflects both the decrease in the depreciation and interest expenses calculated above. It also reflects a small decrease in O&M costs in 2009 (\$25,000) to reflect the movement of some of the forecast expenditures to 2008 (see Exhibit B5.1, part (k)).

IFRS CONVERSION COSTS (\$000'S)

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>Total</u>
Capital Investment	994	263	0	0	1,257
Annual Carrying Cost					
Depreciation	124	281	314	314	
Interest	<u>20</u>	<u>41</u>	<u>33</u>	<u>18</u>	
Total	145	322	347	332	
O&M	1,123	929	96	0	
Annual Cost (pretax)	1,268	1,251	443	332	3,294

By removing the cost impacts associated with the 2008 costs, which Union indicates are costs that cannot be recovered retroactively through a Z factor, Union now fails to meet the materiality threshold both on an annual basis and on a single year basis. The pre-tax

costs do not exceed \$1.5 million in any of the years. Over the four year 2009 through 2012 period, the average annual cost is barely in excess of \$0.8 million per year.

Moreover, the removal of **EITHER** the depreciation expense **OR** the interest expense in both 2009 and 2010 results in the failure to meet the materiality threshold in each of these years. This threshold is also missed in 2009 if **ONLY** the reduction in the O&M expense is taken into account.

If the Board still believes that Union is entitled to the use of a Z factor to recover the costs associated with the one-time event of IFRS conversion even though the costs are less than the materiality threshold on an annual basis, then LPMA has calculated a table equivalent to that of Table 2 in Exhibit A, Tab 1 that shows the revenue requirement associated with the IFRS conversion costs. This table is shown below.

Revenue Requirement

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>Total</u>
O&M	1,123	929	96	0	2,148
Depreciation	124	281	314	314	1,034
Interest	20	41	33	18	112
Return	14	26	21	11	72
Taxes (flow through)	<u>(177)</u>	<u>(151)</u>	<u>92</u>	<u>133</u>	<u>(103)</u>
Total	1,104	1,126	556	476	3,263

Based on this calculation the total to be recovered from customers would decrease from \$4.31 million has proposed by Union (sum of 2009 through 2012 in Table 2) to the total shown above of \$3.263 million.

e) A True Up Mechanism

Union has not proposed any true up mechanism to be associated with this Z factor adjustment (Exhibit B1.1). However, in response to a VECC interrogatory (Exhibit B7.3 (b)), Union indicated that it has no principled concern about the establishment of a deferral account to ensure that the actual costs are recovered, if the Board determines that these costs should be recovered from ratepayers.

LPMA submits that there is another methodology that would result in a true up mechanism if the Board determines that some or all of the IFRS conversion costs qualify as a Z factor adjustment. The forecast amount approved by the Board to be recovered over the appropriate period should be averaged over this period. For example, if the Board were to approve Union's proposal, then the \$4.310 million revenue requirement cost as shown in Table 1 of Exhibit A, Tab 1, should be recovered on the basis of \$1.0775 million per year over this four year period. At Union's next IRM filing for 2010 rates, the cost of \$4.310 million could be updated to reflect actual costs, actual timing of the costs (important for rate base carrying cost and tax consequences). Any change in CCA and/or income tax rates could also be taken into account at this time. The recovery over the three remaining years could then be adjusted to reflect the recovery in the first year and the new total cost forecast. This process would be repeated for the 2011 and 2012 IRM filings.

C) Y Factors

LPMA accepts the Y factors as proposed by Union and their allocation to the various rate classes as being appropriate.

D) Average Use Factor

As a result of an inquiry by LPMA, Union Gas has filed a corrected response to Exhibit B5.2. LPMA believes that this corrected response accurately reflects the EB-2007-0606 Settlement Agreement and accepts the revised 2009 average use volume adjustments shown in Exhibit B5.2 Corrected and reflected in Schedule 10 Corrected.

E) Annual Adjustment to General Service Monthly Charges

LPMA accepts the increase in the fixed monthly charges as approved in the EB-2007-0606 proceeding. Moreover, LPMA believes the adjustment reflected in the decrease in the volumetric delivery charges has been done appropriately and revenue neutral, as shown in Schedule 4 of Union's pre-filed evidence.

F) Other Rate Schedule Changes

Union proposes to amend their rate schedules to the effective annual interest rate of 19.56% that results from the monthly approved late payment charge of 1.5%. As Union indicates, this has no impact on rates, but has been added for informational purposes. LPMA supports this amendment to the rate schedules. Moreover, LPMA believes that any communication with customers are provided with the 1.5% monthly late payment charge, Union should indicate that this is an effective annual interest rate of 19.56%.

G) EB-2008-0304 Decision and Order

On November 19, 2008, the Board issued its Decision approving the transfer of 100% of Union's voting sharing to a limited partnership, subject to three conditions. The third of these three conditions was that Union's rates would be reduced effective January 1, 2009 to reflect the cost reductions of \$1.3 million per year resulting from this reorganization. This saving results from the redemption of Union's preferred shares.

On December 1, 2008 Union wrote to inform the Board that Spectra was not proceeding with the redemption of the preferred shares and that the revenue requirement reduction of \$1.3 million dollars would not materialize. Union further indicated that it would not be reflecting any reduction in its delivery rates effective January 1, 2009.

In the EB-2008-0304 Decision and Order, the Board indicated that an "essential element of this transaction is that the preferred shares will be replaced by debt" (pg. 7). The Board also found that based on the evidence, "the reorganization was dependent on the redemption of the preference shares" (pg. 10).

The Board's Decision clearly indicated that Union had an obligation to disclose the likelihood that Union would reorganize its corporate structure to reduce taxes paid by its parent which in turn would reduce Union's cost of operations. Moreover, had this information been provided to parties this reduction in costs would have become part of the negotiations and settlement that led to the Board's Decision approving the five year incentive rate plan that is currently in place.

LPMA is not aware of any Union filing to vary the EB-2008-0304 Decision. Union has simply said that it will be proceeding with transfer of the voting shares of Union Gas to a limited partnership, while ignoring the Board's third condition to reduce rates effective January 1, 2009 by \$1.3 million per year.

The fact that Union has indicated that it is not proceeding with the redemption of the preferred shares is, in the submission of the LPMA, irrelevant. Union led the Board and intervenors to believe that the redemption of the preferred shares was a necessary component of its planned corporate structure reorganization. The question is whether or not the failure to redeem the preference shares should be considered a Z factor event. Union answered this question themselves in the EB-2008-0304 proceeding, when it indicated that the \$1.3 million reduction related to the redemption of the preferred shares and replacement with debt did not constitute a Z factor. Moreover, LPMA notes that even if the failure to redeem the shares could be considered as a Z factor event because of the world economic conditions that caused Spectra to rethink its plans are beyond the control of management, the pre-tax change in costs is less than the materiality threshold of \$1.5 million required to qualify as a Z factor.

LPMA, therefore, submits that the Board should direct Union to reduce rates by the \$1.3 million determined in the EB-2008-0304 Decision.

H) Recovery of Rate Changes from January 1, 2009

LPMA accepts Union's proposal to implement the Board approved final rates for 2009 on the first billing cycle on or after April 1, 2009 with the variances between interim rates during the period January 1, 2009 and March 31, 2009 and the final rates approved by the customers forming part of an adjustment amount to be recovered from each rate class at the time the final 2009 rates are implemented.

However, LPMA is concerned with this "after the fact" change in rates. This issue is dealt with more fully in the following section.

I) Process

The Board is well aware of the fact that customers do not appreciate the use of interim rates and the prospect of paying more for gas already delivered. LPMA notes that Union filed its application and draft rate order well in advance of the October 31 date required by the approved settlement in EB-2007-0606. In fact, Union filed its application and draft rate order more than a month in advance of this date.

The delay was for the most part a result of a delay of more than one month between Union filing its application and evidence and the issuance of a Notice of Application by the Board. LPMA respectfully submits that the Board should ensure a shorter turn around period for the remainder of the IRM plan term to ensure that interim rates are not required.

LPMA also respectfully submits that a process more in tune with that employed in the EB-2008-0219 proceeding should be employed for future IRM rate filings of Union Gas. In particular, LPMA would find it useful to have a technical conference approximately one week after the response to interrogatories are filed. A settlement conference may also be useful, depending on whether or not there are issues for which discussion are warranted.

LPMA has reviewed the comments of Mr. Thompson in his letter of December 16, 2008 on behalf of his client, the Canadian Manufacturers & Exporters ("CME") in the Enbridge Gas Distribution 2009 Rates proceeding (EB-2008-0219). LPMA supports the comments related to process and agrees that a face-to-face process, in a compressed schedule, is preferable to the written hearing process.

J) Costs

LPMA requests that it be awarded 100% of its reasonably incurred costs of participating in this proceeding.

All of which is respectfully submitted this 29th day of December, 2008.

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