

IN THE MATTER OF the *Ontario Energy Board Act, 1998*; and

IN THE MATTER OF an Application by Union Gas Limited for an Order or Orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas effective January 1, 2009.

**Submissions of
Industrial Gas Users Association (IGUA)**

1. In these submissions, IGUA addresses topics raised by Union's 2009 IRM rates application that are relevant to IGUA's constituents in the same sequence in which those topics are addressed in Union's Argument in Chief.
2. IGUA then comments on three additional topics; i) the information filing obligations of Union under the Board approved EB-2007-0606 Settlement Agreement (*Settlement Agreement*); ii) the inclusion of a \$1.3 million credit to ratepayers on account of certain dividend savings associated with Union's EB-2008-0304 approved reorganization; and iii) the appropriate process for review of IRM applications.

2009 Inflation Factor and Productivity Factor.

3. IGUA takes no issue with Union's derivation of the 2009 inflation factor of 1.54% or the 2009 productivity factor of 1.82%, or with the netting of these two to derive a 2009 Price Cap Index (PCI) of -0.28%.

Z-Factor Adjustments.

Tax changes.

4. Union's Argument addresses the Board's final determination for treatment of tax changes during Union's current IRM plan period.
5. Union's 2008 rates include an \$8 million ratepayer credit on account of savings due to tax changes. At paragraph 13 of its Argument Union indicates that the actual tax savings credit to ratepayers for 2008 should be \$4.146 million. Union indicates that a charge to ratepayers of \$3.854 million will be captured in deferral account 179-119, and disposed of in the upcoming 2008 deferral disposition proceeding. The net result will be a tax changes related credit to ratepayers in 2008 of \$4.146 million¹. IGUA accepts this resolution of ratepayer savings resulting from tax changes for 2008.
6. At paragraph 14 of its Argument Union indicates for 2009 rates, the ratepayer credit on account of savings due to tax changes should be \$5.026 million. Union indicates that a one time \$2.974 increase to rates will be effected for 2009, to effectively remove from rates the \$8 million ratepayer tax savings credit provision implemented in 2008 rates, and replace that interim provision with a 2009 credit to ratepayers of \$5.026 million.² IGUA accepts this rate treatment for ratepayer savings resulting from tax changes for 2009.

International Financial Reporting Standards (IFRS).

7. Union proposes to pass through to ratepayers \$4.209 million of costs that it says will be incurred between 2009 and 2012 and that are associated with preparing for the introduction in 2011 of IFRS. The basis of this proposed pass through is the z-factor exception to the IRM rate adjustment mechanism. The revenue requirement associated with this proposed cost pass through is \$4.310 million between 2009 and 2012.³

¹ See Ex. B5.4 and attachment 1 thereto.

² Reflected at Ex. B5.4 and Attachment 1 thereto.

³ Ex. A-1, page 9, table 2, line 6 figures for 2009 through 2010.

8. IGUA has a number of concerns related to with Union's proposal. It is IGUA's view that;
i) Union has not adequately established that the subject costs pass the materiality threshold for Z factor treatment in 2009; and ii) there is no basis for the Board to approve in this application disposition of these costs beyond 2009.
9. As correctly cited by Union in its Argument, the Board approved IRM *Settlement Agreement* provides that to be eligible for pass through to ratepayers as a Z factor, "*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)*".⁴ [Emphasis added.]
10. The notion behind Z factors is that shareholders should not bear risk, above a certain threshold of consequence, for costs caused by events beyond their control. The corollary notion is that costs of less consequence, even if beyond the shareholder's control, are subsumed in the IRM model.
11. The materiality threshold is an annual threshold. If costs driven by external factors in any given year exceed the threshold, the shareholder is to be relieved of the burden of those costs in that year. (Symmetrically, if costs driven by external factors decrease in any given year by an amount that is less than the materiality threshold, shareholders keep the benefit of those decreases in that year.)
12. Union recognized this interpretation in its evidence in the IRM proceeding. In the IRM proceeding exhibit cited by Union at paragraph 23 of its Argument in this application⁵, Union addressed the issue of the annual Z factor threshold as follows:

The determination of whether an item exceeds the \$1.5 million threshold would be based on annual costs relative to what has been included in rates. If the \$1.5 million threshold was not achieved in a particular year, no collection from customers would

⁴ Union Argument in Chief, para. 7; Settlement Agreement, para. 6.1, p.17.

⁵ Union cites EB-2007-0606, Ex. C3/C16/C33.25 in support of the contention that Z factor materiality is to be evaluated on a pre-tax basis.

occur. In this example, the balance would not be carried forward into the next year. [Part c response, emphasis added.]⁶

13. Even Union's own projections (Ex. A-1, page 6, table 1) indicate that IFRS related costs exceed the \$1.5 million materiality threshold only in 2 years; 2009 and 2010. As a starting point, IGUA submits that Z factor treatment is only a legitimate consideration for \$1.511 million in 2009 and \$1.510 million in 2010. As agreed by Union in the IRM proceeding and endorsed by the Board through acceptance of the *Settlement Agreement*, IFRS related costs in 2011 and 2012 that do not exceed the materiality threshold are subsumed by the IRM formula and are to the account of the shareholder.
14. Examining 2009 and 2010 projected costs, however, IGUA is concerned that they are; i) extremely close to the materiality threshold; and ii) subject to untested assumptions.
15. Consider the forecast 2009 IFRS costs. In 2009 IFRS related costs are forecast to be \$1.511 million. This is a mere \$11,000 (or 0.73%) over the materiality threshold.
16. Included in these costs are \$299,000 of audit fees⁷. IGUA notes that 2009 is the only year in which audit fees are included in IFRS costs. Considering that 2010 is the first year in which results are required to be restated to IFRS, for the purposes of comparison reporting in 2011, it is not clear why Union proposes to spend almost three hundred thousand dollars in IFRS driven audit costs only in 2009. If any part of these audit costs were moved to another year, the IFRS costs forecast for 2009 would not meet the materiality threshold.

⁶ In the same IR, Union posits that once a z-factor is included in rates for a given year, it remains in rates until a further change in costs in respect of that z-factor category exceeds the threshold. Thus an IFRS cost in 2010 of \$1.510 million, for example, would remain in rates from 2010 through the end of the IRM period, unless IFRS related costs decreased by at least \$1.5 million. This is not Union's position in this proceeding. Here Union is proposing smaller annual IFRS Z Factor adjustments. See Ex. B5.1, page 6, part m.

⁷ Ex. B5.1, page 4, response part d.

17. Also included in the 2009 forecast IFRS O&M costs are \$222,000 that represent Union's allocated share of the costs that Union indicates are being shared with Westcoast. In its pre-filed evidence, Union states that it is *"working with other groups within Spectra Energy to share resources and information to avoid duplicating effort and costs"*⁸
18. The basis for this cost sharing is addressed at Ex. B5.1, part h (at page 5), where Union clarifies that *"[t]he cost of resources and information shared between Union and the other groups within Spectra Energy are shared equally between Union Gas and Westcoast, the two Spectra publicly accountable enterprises in Canada"*. The basis for this sharing proposal is not elaborated on, or otherwise justified.
19. How many lines of business, in addition to its regulated Ontario distribution business, is Spectra incurring these costs on behalf of? If \$11,000 of this \$222,000 allocated to Union were instead allocated to another Spectra operation, Union's forecast 2009 IFRS costs would, again, not meet the materiality threshold for z-factor treatment.
20. In this review process, parties have been unable to delve behind the IRs to better understand the basis for these and other judgements made by Union in forecasting IFRS costs.
21. Union was asked by interrogatory whether it had engaged any external assistance in that respect. In Exhibit B7.3 Union responds that it engaged Ernst and Young LLP (E&Y). Union refuses, however, to provide copies of the E&Y reports, claiming that they are confidential under the terms of the services agreement between Union and E&Y.
22. The terms of the services agreement were filed in Exhibit B7.3. What they actually says is that *"...no report (and no portion, summary of abstract thereof) may be disclosed to any third party without EY's prior written consent"*. This restriction on disclosure is very different from a claim that the reports are "confidential". It is unclear to IGUA on what basis a report commissioned by a regulated utility, regarding a matter central to regulatory accounting and setting regulated rates, should be afforded confidential treatment.

⁸ Ex. A-1, page 8, 2nd paragraph.

23. In this cursory review process, cost projections that are within a hair's breadth of the z-factor materiality threshold, and which on their face raise legitimate questions as to quantum and timing, remain completely untested. The best evidence regarding the veracity of these cost projections, the E&Y reports, have not been disclosed. In these circumstances, IGUA respectfully suggests that there is thus insufficient basis for the Board to determine the veracity of the cost forecasts or the prudence of the proposed expenditures.
24. In addition to these evidentiary frailties, the 2010 figure of \$1.510 million is a forecast for costs associated with post-test year phases of IFRS related work. IGUA sees no basis upon which the Board should be asked to approve these future costs in this proceeding. The Board should be particularly reticent to do so given the cursory nature of this review process and the resulting evidentiary frailties of the cost forecasts.
25. Union itself seems to recognize the wisdom of considering only the test year component of the forecast IFRS related costs in noting that *"Union has no incentive under the IR framework to do anything other than make every effort to prudently incur costs since the approval of these costs as a Z factor is not guaranteed in any given year".*⁹
26. In conclusion in respect of IFRS costs, IGUA submits that:
- (a) The Board should limit its consideration in this proceeding to the forecast of IFRS related costs for 2009.
 - (b) The evidence regarding the prudence and Z factor materiality of the IFRS costs forecast for 2009 has not been sufficiently tested. This should be a concern in particular given that; i) the cost forecast exceeds the materiality threshold by the slimmest margin; and ii) in view of the fact that the information provided by Union raises a number of questions about timing and allocation in respect of these costs.
 - (c) Accordingly, the Board should decline to approve Z factor treatment of these costs on a forecast basis as proposed by Union.

⁹ Ex. A-1, page 8, bottom.

27. Some of the interrogatories and responses related to this Z factor claim suggest the use of a deferral account to track actual IFRS related costs, with determination of appropriate disposition to be determined later.

28. In an IR to IGUA [B4.2, part a.] Union states:

Union is not proposing a deferral account because, in Union's view, the costs associated with the conversion to IFRS meet the criteria of a Z factor. Under [sic] incentive regulation framework, the expectation is that material cost increases will be dealt with by Z factors and not deferral accounts.

29. In this statement, Union has inaccurately conflated two separate notions.

30. First in logical sequence is determination by the Board of whether a cost is of a type, subject to materiality, to warrant pass through to ratepayers during an IRM plan period. As noted above, this would be in exception to the general model that during an IRM plan period, cost variances beyond the formulaic IRM adjustment are to the account of the shareholder.

31. If it is determined that the cost is suitable for Z Factor treatment, the next question in logical sequence is how the pass through of that cost is best accomplished. That could be on a forecast basis (as Union has proposed for IFRS related costs in this instance). Alternatively, if there are questions about the forecast (and perhaps if there are questions about the materiality of the costs), the pass through could be accomplished once the actual costs are determined.

32. In other words, the use of a deferral account to record IFRS related costs, for future consideration, is not inimical to the notion that such costs might, subject to materiality, be appropriate for pass through to ratepayers as a Z factor.

33. In this instance in particular, given that IFRS requirements apply in 2011 (and commencing with a restatement of 2010 financials), recovery of material IFRS related preparatory costs in 2010 rates would be quite appropriate.

34. If the Board is ultimately persuaded that it should make provision in its decision on this application regarding recovery of IFRS related costs, such deferral account treatment

would be better, in IGUA's submission, than acceptance of barely material amounts forecast out into the future on untested evidence.¹⁰

Y- factor adjustments.

Upstream gas costs.

35. IGUA agrees with Union that upstream gas cost Y factor adjustments are appropriately addressed through Union's QRAM process.

Upstream transportation Costs - TransCanada DOS-MN.

36. In November, 2008 TransCanada introduced a Dawn Overrun Service - Must Nominate (DOS-MN), which is the subject of an interrogatory to Union from APPrO. Union's response¹¹ indicates that any benefit associated with Union's use of DOS-MN will be used to contribute to S&T transactional margins.
37. In the *IRM Settlement Agreement* ratepayers were credited with \$4.3 million on account of S&T revenues, with all actual S&T revenues going forward accruing to the account of Union's shareholder. Union seems to be proposing that any upstream transportation cost savings resulting from DOS-MN will thus accrue against this ratepayer credit, in favour of Union 's shareholder.
38. Based only on the brief response provided by Union to APPrO's interrogatory, the basis for characterizing DOS-MN transportation cost savings as S&T revenues (accruing to Union's shareholder) rather than upstream transportation cost savings (subject to Y Factor treatment for the benefit of ratepayers), is not apparent.

¹⁰ At Ex. B7.3, page 2, Union indicates that is has "no principled concern" with a deferral account approach.

¹¹ Ex. B2.2.

39. IGUA invites Union to supplement its Ex. B3.3 explanation on this point in its reply argument.

Incremental DSM costs.

40. IGUA accepts Union's position that 2009 DSM program costs of \$20.57 million have been determined in EB-2006-0021, and are appropriately allocated for 2009 in the same manner as DSM costs were allocated in Union's 2007 rates.

Storage margin sharing phase out (as determined in EB-2005-0051).

41. In its NGEIR decision the Board directed Union to phase out the sharing with ratepayers of long-term storage contract margins. To date, Union has included only pre-NGEIR decision long-term storage contracts in these calculations. In its December 10, 2008 ruling in EB-2007-0034 the Board clarified that Union was to include long-term storage contracts entered into after the NGEIR decision as well as those entered into prior to the NGEIR decision in calculation of the ratepayer share of storage margins during the sharing phase out period.
42. Union has indicated in Ex. B3.5 that in respect of 2008 rates, an additional ratepayer credit of \$5.917 is indicated by the Board's December 10, 2008 ruling, and that this credit will be disposed of as part of Union's 2008 deferral account disposition.
43. IGUA assumes that a similar approach will be used to account for the ratepayer share of long-term storage contract margins for 2009. That is, IGUA assumes that inclusion in the 2009 ratepayer sharing calculation of margins from post-NGEIR long-term storage contracts will be effected through inclusion of such margins in the relevant deferral account, rather than by adjusting rates prospectively for 2009 based on an adjusted forecast of those margins with subsequent true-up.

44. IGUA would appreciate confirmation from Union in its reply argument herein that this will be the case.

Other issues.

IRM information filing obligations.

45. Section 11 (pages 23 through 25) of the *Settlement Agreement* sets out the reporting requirements adopted by the Board for Union's IRM plan. These requirements include preparation of a precisely defined list of schedules "*annually for the most recent historical year*".
46. In response to an LPMA interrogatory [Ex. B5.3], Union indicated that actual 2007 financial information is not information that arose "during the IR Plan", and thus need not be filed.
47. While nothing in IGUA's view of this application turns on the provision of this information at this time, IGUA finds this position of Union's disingenuous, and unhelpful.
48. Technically, 2007 actual information is available only in 2008, and 2008 is the first year of formulaic adjustment under the IRM plan, so in IGUA's view Union's position is technically incorrect.
49. More to the point, however, a major purpose of these IRM period information filing requirements is to provide continuity in the information base available to the Board and intervenors, in part in anticipation of the next rebasing application (in this instance, to be brought forward in 2012 for the 2013 test year).
50. As importantly, the provision of this information builds confidence in the IRM mechanism and in the utility's operation thereunder.

51. Little is served by taking an overly rigid (and in any event, incorrect in IGUA's view) position in respect of provision of this information.
52. The Board should direct Union to file its 2007 actual information, pursuant to the Board endorsed *Settlement Agreement*.

\$1.3 million ratepayer credit per EB-2008-0304 Decision.

53. On September 15, 2008 Union filed an application with the Board for approval of certain internal reorganization measures. The measures included redemption by Union of a number of preferred shares, and replacement of those shares with debt. The net result of this part of the reorganization was a forecast savings of \$1.3 million annually.
54. In its November 19, 2008 decision granting leave for the reorganization requested by Union, the Board required as a condition of approval that Union credit ratepayers with \$1.3 million annually from the time of the restructuring, which was to have been completed for the start of 2009.
55. Union subsequently wrote to the Board (on December 1st) indicating that it would not be proceeding with the share redemption, and thus would not be adhering to this condition of approval. Union indicated that it would, however, be proceeding with other aspects of the approved reorganization.
56. By letter to Union dated December 19, 2008, the Board has indicated that if Union seeks to vary any of the conditions of the approval granted in EB-2008-0304, then Union is required to request a review and variance of the decision, and provide the factual basis for such a request.
57. IGUA is not aware at this time of Union having made such a review and variance application.
58. In any event, pending the disposition of any such application, the Board's November 19, 2008 Decision and Order remains in effect.

59. This Panel should require Union to remove \$1.3 million from 2009 rates, in accord with the EB-2008-0304 Decision.

IRM application review process.

60. IGUA has had the benefit of considering the December 16, 2008 letter submitted by Mr. Thompson on behalf of CME in Enbridge Gas Distribution's (EGD) 2009 IRM review proceeding [EB-2008-0219]. In that letter, Mr. Thompson offers comment on the efficacy of a "face-to-face process" for review of rate applications during an IRM period.
61. IGUA agrees with the thrust of CME's submissions in this regard.
62. Phase I of the EGD case is a good example of how a relatively compressed, but complete, schedule of steps can result in expeditious resolution IRM period rate adjustments. In particular, the technical conference held in that proceeding, followed by a brief settlement, was of great assistance to IGUA and, we suspect, other parties, in fully understanding issues and concerns. This full understanding in turn led to a full and timely settlement for the Board's consideration and, ultimately, adoption.
63. Even in an IRM context, there are non-routine, non-formulaic issues. In this case we have a contentious IFRS Z factor issue. If nothing else, a more complete discovery opportunity might have focussed the debate on this issue. In addition, the DOS-MN issue raised in APPrO's interrogatory, and the long-term storage contract margin issues addressed above, might have been quickly resolved through some discussion in advance of the argument stage of the process.
64. In IGUA's view, the process adopted by the Board for EGD's Phase I 2009 IRM application worked well. In particular, the technical conference through which interrogatories could be responded to, and prior written responses could be clarified, was an efficient way to provide expedited discovery on issues that were largely non-contentious, particularly when clarified. In the result, the settlement was effective, quick and complete.

65. The only modification that we would suggest to the process adopted for the EGD application is to allow a bit more time between the provision by the applicant of interrogatory responses and the technical conference. In the EGD process the written IRs were delivered by EGD on the morning of, and at the start of, the technical conference. IGUA does not impugn EGD for this timing; only two days were allowed for EGD to respond to interrogatories. A few more days for response and review of the responses would have rendered the technical conference both more efficient and more informative.

Conclusion and costs.

66. IGUA hopes that these submissions are of assistance to the Board in its deliberations on this application. IGUA requests that it be awarded 100% of its reasonably incurred costs for intervention in this proceeding.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Macleod Dixon, LLP

per:



Ian Mondrow
December 31, 2008

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