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December 31, 2008

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge Street  
27<sup>th</sup> floor  
Toronto ON M4P 1E4

Dear Ms Walli,


**Union Gas Limited ("Union") 2009 Rates**

**Board File No.: EB-2008-0220**

**Our File No.: 339583-000020**

Please find attached the Final Submissions of Canadian Manufacturers & Exporters ("CME") in the above-noted proceeding. Paper copies will follow shortly.

Yours very truly,

*for*   
for Vincent J. DeRose

\slc

enclosure

c. Union Gas Limited  
Interested Parties EB-2008-0220  
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**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 just and  
reasonable rates and other charges for the sale, distribution,  
transmission and storage of gas effective January 1, 2009.

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**ARGUMENT OF  
CANADIAN MANUFACTURERS & EXPORTERS (“CME”)**

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**December 31, 2008**

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**A. Introduction**

1. CME's submissions with respect to Union's Application to fix rates as of January 1, 2009, are made under the same topic headings used by Union in its pre-filed evidence and Argument-in-Chief, with one additional topic heading entitled "Another 2009 Revenue Reduction Item".
2. As will be seen from the submissions which follow, apart from expressing a concern about Union's approach to certain upstream transportation cost reductions available from TransCanada PipeLines Limited ("TCPL") and the low level of storage premiums embedded in base rates, the focus of CME's submissions are on the following two points:
  - (a) Union's failure to establish Z Factor eligibility for its forecasted 2009 International Financial Reporting Standards ("IFRS") conversion costs; and
  - (b) Union's failure to reduce its 2009 rates by \$1.3M as a result of the Board's November 19, 2008 Decision in EB-2008-0304 and its letter to counsel for Union and Westcoast Energy Inc. ("Westcoast") dated December 19, 2008.
3. On these two points, CME supports and adopts the submissions made by the City of Kitchener ("Kitchener") in its Written Argument circulated on December 23, 2008. CME's rationale for supporting Kitchener's submissions is detailed more fully below.
4. CME has also reviewed the argument of the London Property Management Association ("LPMA") circulated by Mr. Aiken on December 29, 2008. Mr. Aiken argues a "threshold question" as to whether Union's IFRS conversion costs

qualify as a Z Factor adjustment, and then addresses matters pertaining to what he characterizes as the “subsequent question”, the “follow-up question” and the “adjustment to eliminate 2008 cost impacts”. For the reasons that follow, we submit that all of these matters are relevant to the issue of whether Union’s IFRS conversion costs in 2009 qualify as a 2009 Z Factor.

**B. 2009 Inflation Factor and Productivity Factor**

5. CME accepts Union’s calculations of the Inflation Factor, at 1.54%, and the Productivity Factor, at 1.82%, with the result that the price cap for 2009 is a net reduction of 0.28%.

**C. Z Factor Adjustments**

(a) Tax Changes

6. CME accepts that Union has correctly calculated the tax savings adjustments for 2008 and 2009 as a result of the Board’s July 31 and December 10, 2008 Decisions, to which Union refers in paragraphs 11 and 12 of its Argument-in-Chief. Specifically, CME accepts that the sum of \$3.854M should be recorded in deferral account no. 179-119 and disposed of in the 2008 deferral disposition proceeding to which Union refers in paragraph 13 of its Argument-in-Chief.
7. CME also accepts that in order to recognize the Board’s July 31 and December 10, 2008 Decisions, the \$8M interim adjustment to 2008 rates must be removed and replaced with an amount of \$5.026M, the effect of which is a 2009 net rate increase of \$2.974M which Union describes in paragraph 14 of its Argument-in-Chief.

(b) International Financial Reporting Standards (“IFRS”)

8. CME’s analysis of Union’s claim in paragraph 25 of its Argument-in-Chief that \$4.209M of multi-year projected IFRS costs are recoverable from ratepayers as a Z Factor begins with a consideration of the guiding principles with respect to Z Factors established in the Board’s July 21, 2001 Decision with Reasons in RP-1999-0017.
9. The Board’s discussion of these guiding principles is found at pages 91 to 99 of Volume 1 of the Decision with Reasons. In the context of these guiding principles, CME submits that Z Factors are “non-routine adjustments” associated with “unpredictable” or “unforeseeable circumstances”.<sup>1</sup> To be recoverable, the non-routine costs must be outside the base upon which rates were derived and must exceed a pre-determined materiality threshold.<sup>2</sup> Z Factor eligibility is to be determined year-by-year during the term of an Incentive Regulation (“IR”) Plan.<sup>3</sup>
10. It is actual costs and not forecasted costs which are recoverable once Z Factor eligibility and materiality is convincingly established. If evidence convincingly establishes Z Factor eligibility and materiality, then a tracking account is used to record the actual costs incurred.<sup>4</sup>
11. Some of these concepts are reflected in the provisions of the Settlement Agreement which are recited in paragraph 7 of Union’s Argument-in-Chief.
12. In the context of the guiding principles reflected in the Board’s RP-1999-0017 Decision with Reasons, and the criteria listed in the Settlement Agreement, CME

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<sup>1</sup> See paras. 2.294, 2.315 and 2.320 of RP-1999-0017 Decision with Reasons

<sup>2</sup> See paras. 2.324 and 2.325 of RP-1999-0017 Decision with Reasons

<sup>3</sup> See para. 2.326 of RP-1999-0017 Decision with Reasons

<sup>4</sup> See para. 2.323 of RP-1999-0017 Decision with Reasons where the Board stated “*The Board is of the view that non-routine adjustments relating to events or changes should reflect actual costs to the maximum extent possible.*”

suggests that the question for the Board to determine is whether Union's evidence convincingly provides a *prima facie* demonstration that 2009 IFRS conversion costs are eligible for Z Factor treatment.

13. When considering this issue, CME submits that the first question the Board should consider is whether the projected multi-year IFRS conversion costs were "unexpected" or "unforeseen" on January 3, 2008, when the terms of the EB-2007-0606 Settlement Agreement between Union and intervenors were finalized.
14. CME submits that the evidence indicates that projected multi-year IFRS conversion costs were not unexpected or unforeseeable on January 3, 2008. The evidence in Exhibits B3.2 and B6.2 indicates that the potential for IFRS conversion costs was announced in 2006. Further, Exhibit B7.3 confirms that Union's parent company, Spectra Energy Corporation ("Spectra"), engaged Ernst & Young LLP ("E&Y") in October 2007 to assist in the diagnostic phase of the IFRS conversion project. The E&Y November 27, 2007 engagement letter with Spectra indicates that Spectra would be required to report its financial statements under IFRS on or after January 1, 2011, and to include in its 2008 and 2009 reporting a description of their plans for converting to IFRS.
15. The IFRS conversion process is not being undertaken only for the benefit of Westcoast and Union. The companies within the Spectra family of companies that have an interest in the conversion to IFRS include Spectra, Westcoast and all of its subsidiaries, and Union. As confirmed at page 2 of the E&Y engagement letter (Exhibit B7.3), the scope of E&Y's work for Spectra was to:

*“... include the review of activities and transactions that currently reside in Westcoast Energy Inc. and its subsidiaries; and Union Gas Limited.”  
(emphasis added)*

16. The engagement letter between Spectra and E&Y confirms that Spectra planed to complete the Diagnostic Assessment before December 14, 2007.<sup>5</sup> This shows that prior to the finalization of the Settlement Agreement on January 3, 2008, it was known that Spectra, Westcoast and its subsidiaries, and Union would be faced with multi-year IFRS conversion costs. Accordingly, these multi-year IFRS conversion costs are neither unexpected nor unforeseen.
17. The next question the Board should consider when determining whether Union's evidence *prima facie* demonstrates Z Factor eligibility for projected multi-year IFRS conversion costs is whether such costs are a cost increase not otherwise reflected in Union's price cap index and plan. In this context, CME emphasizes that Union's price cap index and plan covers carrying costs on all incremental capital expenditures. There is no incremental capital module protection of any nature in Union's price cap plan. Similarly, Union's price cap plan does not include any Y Factor protection for IFRS conversion costs comparable to the “power plant” Y Factor protection found in the Board approved price cap index and plan for Enbridge Gas Distribution Inc. (EB-2007-615).
18. While Union's price cap plan includes deferral account protection for certain categories of anticipated expenditures where the amounts incurred are beyond the company's control, Union did not seek and does not have any deferral account protection for its IFRS conversion costs. In fact, Union acknowledges in Exhibit B4.2 that:

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<sup>5</sup> See page 2 of Attachment 1 to Exhibit B7.3

*"Under incentive regulation framework, the expectation is that material cost increases will be dealt with by Z factors and not deferral accounts."*

19. CME submits that this is an acknowledgement by Union that Z Factor eligibility must be established before it can recover any IFRS conversion costs in its 2009 rates.
20. Based on the foregoing, CME submits that the IFRS multi-year projected conversion costs are not eligible for Z Factor protection. These costs were expected and foreseeable prior to January 3, 2008, when the Settlement Agreement was finalized. Further, they are covered by the price cap index and plan because they are not protected by a Y Factor, a deferral account, or some form of incremental modular protection of the type the Board established in its 3rd Generation Incentive Regulation Plan for electricity distributors.
21. In the event the Board rejects the foregoing submissions and finds that anticipated and foreseeable multi-year IFRS conversion costs are arguably eligible for Z Factor coverage, then, in order for Union to justify the establishment of a tracking account for 2009, it must convincingly establish that it will likely incur IFRS conversion costs in 2009 which meet the "annual" materiality threshold of \$1.5M specified in the Settlement Agreement.
22. The position expressed in paragraph 25 of Union's Argument-in-Chief that \$4.209M of multi-year projected costs associated with its conversion of IFRS by January 1, 2011, are recoverable as a Z Factor because the total amount exceeds the materiality threshold is untenable. The Z Factor provisions of the Board approved Settlement Agreement established that "the cost increase/decrease must meet the materiality threshold of \$1.5 million annually

per Z factor event” (page 17 of the Settlement Agreement for EB-2007-0606) (emphasis added).

23. Further, in the EB-2007-0606 proceedings, Union, when responding to an interrogatory from BOMA, LPMA and WGSPG confirmed that “Union will not seek a Z Factor adjustment to rates until the \$1.5M threshold is exceeded annually ...” and that “the determination whether an item exceeds the \$1.5M threshold would be based on annual costs relative to what had been included in rates. If the \$1.5M threshold was not achieved in a particular year, no collection from customers would occur.” A copy of Union’s interrogatory response, Exhibit C3/C16/C33.25, to which Union refers in paragraph 23 of its Argument-in-Chief, is attached to this Argument.
24. Union’s current position that a multi-year projection of costs in an amount exceeding \$1.5M, *i.e.* the \$4.209M to which Union refers in paragraph 25 of its Argument-in-Chief, qualifies for Z Factor treatment is incompatible with the language of the Settlement Agreement and Union’s evidence in Exhibit C3/C16/C33.25 in the EB-2007-0606 proceeding. On the basis of the IR regime approved by the Board in EB-2007-0606, whether an item of expenditure exceeds the Z Factor materiality threshold is determined on the costs in the year being considered, which in this case is 2009.
25. In its evidence and Argument-in-Chief, Union states that pre-tax costs are the relevant costs for the purposes of measuring the materiality threshold of \$1.5M. Some parties may question whether the Z Factor materiality threshold should be determined on a revenue requirement standard instead of a pre-tax costs

standard. If a revenue requirement standard is used to measure materiality, then, as shown in Table 2 in Union's pre-filed evidence, the amount in 2009 clearly falls below the materiality threshold of \$1.5M.

26. If the revenue requirement standard is used to measure threshold materiality, then the forecast IFRS conversion costs reasonably allocated to Union in 2009 are ineligible for Z Factor treatment and, as a result, are a shareholder responsibility. As well, for reasons that follow, the pre-tax IFRS conversion costs reasonably allocated to Union for 2009 fall below the annual Z factor materiality threshold of \$1.5M.
27. When considering whether the conversion costs in Table 1 for 2009 of \$1,511,000.00 meet the annual materiality threshold of \$1.5M, the Board should examine the extent to which these total forecast costs are influenced by capital expenditures (for which there are no "incremental" capital modular protection under Union's price cap plan). The Board should also examine the extent to which the costs have been allocated over the three years 2008, 2009 and 2010, and the extent to which the costs have been allocated between Spectra, Westcoast and its subsidiaries, and Union.
28. Taking the last point first, it is clear from E&Y's engagement letter with Spectra (Exhibit B7.3) that all corporations within the Spectra organization, including Spectra, Westcoast and its subsidiaries, and Union, will be converting to IFRS, regardless of the fact that they may not all be "publicly accountable companies". Yet, as shown in Exhibit B5.1, page 5, 50% of the total shared costs in 2009 of \$222,000.00 are being allocated to Union as part of the "consulting" and "project

management” costs shown in Exhibit B5.1, page 4, answer (d). If these costs are allocated to all companies within the Spectra organization, the forecasted conversion costs in Table 1 would fall below the materiality threshold of \$1.5M.

29. In terms of the distribution of costs between the years 2008, 2009 and 2010, it is noteworthy that none of the audit fees of \$299,000.00 shown in Exhibit B5.1, page 4 are allocated to either 2008 or 2010. On its face, the loading of such costs into 2009 appears biased.
30. Further, as counsel for Kitchener and Mr. Aiken for LPMA note in their Arguments, some of the depreciation and interest costs in 2009 shown in Table 1 of Union’s pre-filed evidence relate to 2008 investments which Union acknowledges should be excluded from Z Factor treatment. As well, the annual carrying costs total of \$363,000.00 relates to capital expenditures which are covered under Union’s price cap plan because of the absence of any Y Factor or incremental capital module protection.
31. In all of these circumstances, CME submits that Union has failed to convincingly make a *prima facie* demonstration that IFRS pre-tax conversion costs in 2009 are likely to exceed the materiality threshold of \$1.5M. As such, Union’s request for Z Factor recovery in 2009 of IFRS conversion costs in the amount of \$1,511,000.00 should be rejected.
32. Whether or not IFRS conversion costs in 2010 will qualify for Z Factor treatment is an issue that is to be determined in Union’s Application for rates effective January 1, 2010.

**D. Y Factor Adjustments**

(a) Upstream Transportation Costs

33. In Exhibit B2.2, Union indicates that it has contracted for what CME understands to be some cheaper upstream transportation made available by TCPL. The interrogatory response states “Union is not treating any benefit associated with the use of the DOS-MN as a Y Factor.” CME questions why reductions in upstream transportation costs are not being flowed through to the benefit of Union’s ratepayers.
34. CME requests that Union explain in its Reply Argument why these cost reductions in upstream transportation are not being passed through to ratepayers as part of the upstream transportation costs Y Factor.

(b) Storage Margin Sharing Changes

35. In Exhibit B3.5, Union reports that the actual 2007 long term peak storage revenues were \$32.22M, compared to the \$21.405M forecast embedded in base rates, for a variance of \$10.817M. The response indicates that, as a result of the Board’s Decision in EB-2008-0154, ratepayers will be credited with an additional \$5.917M for 2007 as part of the 2008 deferral account disposition. CME questions why ratepayers should have to wait until the 2<sup>nd</sup> quarter of 2009 to receive the balance of their 2007 share of storage premiums.
36. CME also considered whether the \$21.405M forecast embedded in rates is materially low, and considered making a submission to the effect that the amount embedded in base rates for storage margin sharing in 2009 be increased.

37. These are essentially timing issues because, eventually, ratepayers will recover the increased share of storage margin which results from the long term peak storage revenues materially exceeding the amount of \$21.045M embedded in base rates. Despite its reservations, CME is not suggesting any specific relief with respect to these matters. We will leave it to the Board to determine whether the 2007 storage premium credit of \$5.917M should be cleared to ratepayers now rather than later, and whether the storage margin sharing amount embedded in base rates of \$21.045M should be increased for 2009.

**E. Average Use Factor**

38. CME relies upon and adopts Mr. Aiken's analysis of this issue.

**F. Annual Adjustment to General Service Monthly Charges**

39. CME accepts that Union has correctly applied this element of the Settlement Agreement.

**G. Other Rate Schedule Changes**

40. CME has no objection to the cosmetic Rate Schedule changes Union proposes.

**H. Another 2009 Revenue Reduction Item**

41. As a result of the Board's letter to counsel for Union and Westcoast dated December 19, 2008, CME adopts and supports the submissions of Kitchener and LPMA that Union's 2009 rate levels need to be reduced by \$1.3M. Should Union bring a motion to review the Board's Order requiring a rate reduction of \$1.3M and should the Board grant the relief Union seeks, then 2009 rates can be adjusted to reflect the review and variance order. At this point in time, the Board's Order should be respected.

**I. Customer Impacts**

42. CME has no submissions to make with respect to customer impacts. The customer impacts of tax savings adjustments resulting from the Board's July 31 and December 10, 2008 Decisions, which Union refers in paragraphs 11 and 12 of its Argument-in-Chief, and the further rate reduction of \$1.3M cited above, will be reflected in the Working Papers that Union provides to support the Order emanating from these proceedings.
43. In paragraph 36 of its Argument-in-Chief, Union states that the impact of the changes it proposes represent an increase of between 0.4% and 0.6% of the total annual residential bill. The question posed by CME in Exhibit B3.7 noted that despite the price cap reduction of 0.28%, the delivery rate bill impacts on all in-franchise customers were rate increases, ranging in percentage amounts from 0.8% for Rate T3 in the South, to 2.5% for Rate M7 in the South and Rate 20 in the North. CME submits that it is important to recognize that the price cap change does not necessarily reflect the direction that overall delivery rate changes will take and that, in this case, despite a price cap reduction of 0.28%, the delivery rate impact of all factors affecting 2009 rates produces, for some rate classes, rate increases which exceed the rate of inflation of 1.54%.

**J. Recovery of Rate Changes from January 1, 2009**

44. CME accepts as reasonable a rate implementation date of April 1, 2009 as Union proposes.

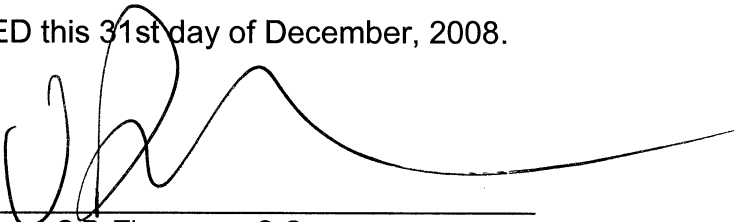
**K. Summary**

45. For these reasons, CME submits that Union has failed to establish a *prima facie* case that the 2009 IFRS conversion costs of the Spectra group of companies reasonably allocable to Union will likely exceed the Z Factor materiality threshold of \$1.5M. As such, the rate levels Union has proposed for 2009 should be reduced by the \$1.511M. If the Board concludes, however, that Union has established a *prima facie* case for Z factor treatment of the IFRS costs, then the relief granted to Union should be limited to the establishment of a tracking account. Finally, the rate levels Union has proposed for 2009 should also be reduced by the \$1.3M rate reduction effective January 1, 2009, described in the Board's letter to counsel for Union and Westcoast of December 19, 2008.

**L. Costs**

46. CME respectfully requests that it be awarded 100% of its reasonably incurred costs of participating in these proceedings.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 31st day of December, 2008.



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Peter C.P. Thompson, Q.C.  
Vincent J. DeRose  
Counsel for CME

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")

*Reference: Ex. B, Tab 1, page 40*

*Issue 6.2 - Should there be materiality tests, and if so, what should they be?*

***Question:***

- a) Please confirm that the materiality threshold proposed by Union of \$1.5 million is pre-tax and not after-tax.*
  - b) Is the materiality threshold a cumulative test or a year to year test? For example, assume that permit fees are an appropriate Z factor and that Union pays \$1 million in fees in 2008 and \$2 million in 2009. Under one possible interpretation, in 2008, the \$1 million expense would not reach the materiality threshold of \$1.5 million. The increase in 2009 is a further \$1 million from 2008, which again, would not meet the materiality threshold. However under another possible interpretation, the increase in 2009 as compared to base rates is an increase of \$2 million, which would pass the materiality test. Which of these two interpretations does Union's materiality test proposal envision?*
  - c) In the above scenario, if a deferral account had been set up for 2008 and at the end of 2008, it had the \$1 million expense recorded in it and the amount failed the materiality test, would the balance be set to \$0 at the beginning of 2009 or would Union propose to carry forward this balance into 2009 and ultimately seek recovery of the 2008 amount if and when the balance in the account exceeded the materiality threshold?*
  - d) Please define a Z factor event in the context it is used in the materiality section of Table 4.*
  - e) If the provincial corporate tax rate decreased, resulting in a reduction to Union Gas of \$1 million and the provincial capital tax was reduced by a further \$1 million both the result of tax legislation, would each of these items be considered separate Z factor events, or would they be considered jointly as one Z factor event? Please explain.*
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Question: August 20, 2007

Answer: September 4, 2007

Docket: EB-2007-0606

**Response:**

- a) The materiality threshold proposed by Union of \$1.5 million is pre-tax and not after-tax.
- b) The materiality threshold is an annual per event threshold. With respect to permit fees, Union will not seek a Z factor adjustment to rates until the \$1.5 million threshold is exceeded annually. No permit fee costs are included in 2007 base rates. Once rates are adjusted to include a base level of permit fees, the determination of whether a subsequent Z factor adjustment to rates is warranted will depend on what the cost of permit fees is relative to what has previously been included in rates.
- c) The determination 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 occur. In this example, the balance would not be carried forward into the next year.
- d) A Z factor event as used in the Materiality section of Table 4 would be the same type of event described in the Inability of Management to Control section of Table 4.
- e) These would be two separate Z factors events that would not meet the \$1.5 threshold.

Question: August 20, 2007

Answer: September 4, 2007

Docket: EB-2007-0606