

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 for an order or orders approving or fixing a multi-year
incentive rate mechanism to determine rates for the regulated
distribution, transmission and storage of natural gas, effective
January 1, 2009.

**SUBMISSIONS OF THE
SCHOOL ENERGY COALITION**

December 31, 2008

SHIBLEY RIGHTON LLP

250 University Avenue, Suite 700
Toronto, Ontario M5H 3E5

John De Vellis
Tel: 416.214.5232
Fax: 416.214.5432

Email: john.devellis@shibleyrighton.com

Counsel for the School Energy Coalition

INTRODUCTION

1. These are submissions of the School Energy Coalition ("SEC") in response to the application and Argument in Chief submitted by Union Gas Ltd. ("Union" or the "Applicant") for an order approving just and reasonable rates for the sale, transmission, and storage of gas as of January 1, 2009.

2. SEC's comments are restricted to two areas:

- (a) Union's proposed Z-Factor Adjustments, in particular the z-factor adjustment related to accounting system changes resulting from conversion to the International Financial Reporting Standards ("IFRS");
- (b) Union's calculation of 2009 income taxes, in particular its compliance with the Board's Decision and Order in EB-2008-0304

a.) IFRS Z-Factor

3. In SEC's submission, the proposed Z-factor for IFRS-related costs should be rejected, for two reasons:

- (i) Union was aware it would be incurring IFRS conversion costs when it filed its evidence in the incentive regulation proceeding. An event should not qualify as a z-factor event if it was known to management at the time the incentive regulation framework was established.
- (ii) Union has not established that it has met the materiality threshold of \$1.5 million required to qualify as a Z-factor under the settlement agreement approved by the Board in EB-2007-0606.

i.) Union Aware of IFRS Issue in 2007

4. It is clear from the interrogatory responses that Union was aware of the IFRS conversion issue prior to or at the same time that it was filing its evidence in the 2008 incentive regulation proceeding [EB-2007-0606].

5. Union has stated, for example, that the Canadian Institute of Chartered Accountants ("CICA") initially raised the potential for conversion from Canadian GAAP to IFRS in 2006, although it did not confirm the requirement until February 2008 [Exhibit B3.2] \

6. Union retained Ernst and Young to perform an initial diagnostic in October 2007. [B6.2] The initial diagnostic was completed in late 2007, and it was at that time that Union became aware of the impact of IFRS on its accounting system [Ex. B6.2(e)]

7. At the very least, therefore, Union was aware of the potential for IFRS costs and had taken action in regard thereto prior to or at the same time that it was filing its evidence in the 2008 incentive regulation proceeding.

8. In SEC's submission, z-factors are meant to provide for unforeseen events that are outside of management's control. Therefore, an event should not qualify for z-factor treatment if it was already known to management at the time the incentive regulation framework was established.

9. If Union was aware of the issue when it filed its evidence in the incentive regulation proceeding it should have disclosed it to the parties at that time. In that way, the issue could have been fully explored during that proceeding and the parties could have determined whether it was an appropriate Y-factor adjustment.

ii.) Evidentiary Record

10. Under the terms of the settlement agreement in EB-2007-0606 [the "IRM Rate Case"] an event does not qualify as a z-factor unless "the cost increase/decrease [meets] 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).

11. It appears that Union believes it has met that test because its estimated costs for 2009, \$1.511 million, exceed the \$1.5 million threshold. [Ex. A, Tab 1, pg. 9]

12. However, Union is also asking that the revenue requirement impact of subsequent years be approved in this application, even when the impact in those years does not meet the threshold. Union has justified its position on the basis that, because a large proportion of the IFRS costs are capital costs, there will be revenue requirement impacts beyond 2009. The effect of Union's

position would be that a z-factor would only have to meet the threshold in one year for the costs in all subsequent years to receive z-factor treatment. That does not appear to be consistent with the wording of the settlement agreement, which states that the threshold is "\$1.5 million annually".

13. In any event, Union's estimate of the 2009 IFRS-related costs, \$1.511 million, barely meets the threshold set out in the settlement agreement and it is not clear from the evidence whether that estimate is justified.

14. In the first place, although Union retained Ernst and Young to assist it with the conversion, it did not obtain a specific report from Ernst and Young outlining the cost estimates [Exhibit B6.1(c)]

15. It is also apparent from the interrogatory responses provided by Union that Union made a number of assumptions in order to arrive at the 2009 figure of \$1.511 million. As discussed below, there is insufficient evidence in this proceeding to conclude that those assumptions were reasonable.

16. For example, the O&M costs for 2009 include \$299,000 in audit fees. Union has assumed that all of the audit fees in relation to IFRS conversion will be incurred in 2009 [Exhibit 5.1(d), p. 4] Given that the conversion to IFRS does not need to be completed until January 1, 2011 [Exhibit A, Tab 1, p. 5], and Union will be doing additional work in 2010, it is not clear why all of the audit fees are incurred in 2009.

17. In addition, the costs that Union has shared with its affiliate, Westcoast Energy, are split 50/50 between the two companies [Exhibit 5.1(h)] There is no evidence as to how the 50% allocation was arrived at or why it is justified. Given that all of the shared costs are O&M [Ex. 5.1(h)] even a slight change in the allocation proportions could put Union under the threshold.

18. In SEC's submission, given how closely the projected IFRS costs come to the threshold level, there is not enough evidence for the Board to conclude that Union has met its onus of establishing that the costs truly exceed the threshold.

b.) Compliance with EB-2008-0304

19. In EB-2008-0304, Union applied to the Board pursuant to section 42(2) of the *Ontario Energy Board Act, 1998* requesting leave of the Board to transfer a controlling interest in Union from Westcoast Energy Inc. to a limited partnership to be organized under the laws of Ontario.

20. The Board found that the rationale for the proposed transaction is the significant tax savings to Spectra Energy Corporation, Union's U.S.-based parent company. [EB-2008-0304 Decision and Order, p. 3 (the "Reorganization Decision")]

21. One element of the proposed transaction was that the existing preferred shares in Union would be converted to debt. Because the cost rate of debt is less than preferred share, there is a reduction in Union's revenue requirement in the amount of \$1.3 million annually. [Reorganization Decision, p. 3, 7]

22. The Board approved the transaction subject to three conditions, one of which was that "Union's rates will be reduced effective January 1, 2009 to reflect the cost reduction of \$1.3 million per year resulting from this reorganization." [Reorganization Decision, p. 13]

23. On December 1, after the release of the Board's decision in the matter, Westcoast Energy Inc., Union's parent company, wrote to the Board to advise that its plans had changed. It was still planning on going ahead with the transfer of 100% of the voting shares of Union Gas Ltd. to a limited partnership organized under the laws of Ontario, but it would not be going ahead with the preferred share redemption. As a result, the revenue requirement reduction of \$1.3

million would not materialize and, Westcoast said, "Union will not be reflecting any reduction in its delivery rates effective January 1, 2009."

24. Several intervenors wrote to the Board in response to Westcoast's letter arguing that Union could not unilaterally change the conditions of the Board's Order.

25. In this proceeding, Union reiterated, in an interrogatory response, the position set out in Westcoast's letter of December 1 that it will not be reflecting any reduction in its 2009 delivery rates. [Exhibit B5.5]

26. After Union's interrogatory responses were delivered, however, the Board, on December 19, 2008, the Board issued a letter to counsel for Union and to Westcoast stating that if Union feels it should not have to comply with the Board's order it must bring a motion for review.

27. In SEC's submission, as a result of the Board's original order in the Reorganization Decision as well as the letter of December 19, 2008, Union is required to reduce distribution revenue requirement, and the ensuing delivery rates, by \$1.3 million effective January 1, 2009.

28. In SEC's submission, that result is not only the compliant with the Board's December 19, letter but also correct. It is not possible to determine the ramifications of Westcoast's/Union's decision to alter the nature of its reorganization without a full evidentiary record. A full evidentiary hearing would determine whether, in all the circumstances, the revised version of the transaction warrants a review or variance of the Board's original decision approving the transaction. Union cannot, in SEC's respectful submission, choose to accept one portion of the decision (the portion approving the transaction) and unilaterally ignore another portion of it. Such a result would undermine the regulatory process.

Costs

29. SEC participated responsibly in this proceeding and sought to contribute to the Board's understanding of the issues. SEC therefore respectfully requests that it be awarded 100% of its reasonably incurred costs.

All of which is respectfully submitted this 31st day of December, 2008.

John De Vellis
Counsel to the School Energy Coalition