EXECUTIVE SUMMARY
RP-1999-0017

Union Gas Limited ("Union") filed an application under section 36 of the Ontario Energy Board Act, S.O. 1998, c.15, schedule B with the Ontario Energy Board ("the Board"), dated March 5, 1999, for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission, and storage of gas. The rates and other charges for which approval was requested would be effective January 1, 2000, and thereafter in accordance with a performance based regulation ("PBR") price cap mechanism which would set limits on the prices for regulated services offered by Union for a proposed initial term of five (5) years.

Union proposed a fixed price cap of 1.9% for each year of the plan and, starting with the 1999 rates approved in EBRO 499, calculated a delivery revenue for 2000 of $846.5 million after adjustments to delivery revenue and pass-through items. The proposed price cap mechanism also provides for certain service quality standards, the pass through of changes in certain items directly into rates, and "off ramps" to permit further regulatory adjudication in the event of certain unforecast occurrences.

Union also applied for an order approving the unbundling of certain rates charged for the sale, distribution, transportation, and storage of gas.

The Board has decided that it would be in the public interest to approve, on a trial basis and for a shorter period than was applied for, a PBR price cap plan that is a modification of Union's proposal; this will allow the Board and all parties to explore the benefits and dis-benefits in comparison with the traditional annual or bi-annual adjustment of rates based on a forecast cost of service.

This Decision establishes rates for the year 2000 and puts in place a three-year PBR plan for the years 2001-2003 in which the price cap will be changed annually based on changes in the Gross Domestic Product Price Index (GDPPI).

The Board has accepted the use of the Board-approved 1999 delivery revenue of $787.2 million as a starting point for determining rates for year 2000. The Board has also accepted the use of 1999 approved volumes in calculating the rates. Due to the passage of time and events, the Board found that adjustments to the 1999 approved delivery revenue were necessary to establish a more relevant base. Further, the Board has decided that the initial price cap increase should not occur before January 1, 2001.

In setting the delivery revenue base for 2000, the Board approved reallocation adjustments to the $787.2 million for delivery/redelivery and storage revenue in the Northern and Eastern Operations Area ($31.5 million increase) and for short-term gas supply ($7.6 million decrease). This results in a delivery revenue base of $811.1 million. In determining the approved delivery revenue for fiscal 2000, the Board has approved the following additional adjustments to delivery revenue for fiscal 2000: a decrease to base rates of $14.3 million (accounting changes for pensions and post-retirement benefits, deferred tax amortization, and other Board adjustments) and an increase for pass-through items of $20.1 million (ROE, unaccounted-for gas, and gas related delivery costs). Therefore, the Board-approved delivery revenue for fiscal 2000 is $816.9 million.

For the trial price cap plan, the Board has approved the use of the GDPPI available from Statistics Canada as an appropriate measure of overall price inflation (the I-factor). The Board finds that the I-factor should be calculated as the year-over-year increase reflected by the most recent data for the Canadian Chain GDPPI available from Statistics Canada prior to the time at which the annual price cap index for the subsequent year would be set on a going forward basis. On this basis, the Board has determined the year 2001 I-factor to be 3.9%.

The evidence indicated that Union's input prices grow more slowly than input prices economy-wide and, based on the data before it, the Board approves -1.1% as the input price differential for the term of Union's trial PBR plan.

The Board expects that Union will be able to achieve positive productivity growth under PBR and, given that expert evidence indicated that a reasonable stretched productivity offset for Union lies in the range of 1.4% to 2.3%, for the purposes of the trial PBR plan the Board approves a stretched productivity offset of 1.4%.

The Board's findings with respect to a stretched productivity factor of +1.4% and an input price differential of -1.1%, yields an X-factor of 2.5%. This X-factor will be combined with the GDPPI to derive the price cap escalator for 2001, 2002, and 2003.

Therefore, the Board has determined that Union's price cap escalator for 2001 will be 1.4%.

The Board accepts that a provision for non-routine (Z-factor) items is appropriate within a price-cap plan and agrees that the use of Z-factors related to changes in legislative and regulatory requirements and generally accepted accounting principles specific to the natural gas business is appropriate. The Board accepts Union's proposed materiality thresholds for Z-factor treatment and notes that the customer review process, which the Board also approved in this Decision, will provide a forum in which proposed Z-factors, among other issues, can be discussed.

In general, the Board finds it inappropriate to escalate Z-factor and other pass-through adjustments under the price cap. Specifically, with respect to gas-cost related pass-through items, the Board finds that these should not be escalated under the price cap. The Board finds that the full amount of gas-related delivery costs embedded in rates must be removed prior to applying the price cap in any year of the plan. The Board notes that these are also specific items which are forecast annually and dealt with through the customer review process.

Although an ROE pass-through is not a typical feature of a comprehensive PBR plan, because 2000 is a transition year for which adjustments have been approved and no price cap is being applied, the Board has approved an ROE pass-through adjustment for 2000. The Board has determined that the adjustment to be applied in developing rates for 2000 shall be, including income taxes, $5.632 million. This adjustment reflects the actual income tax rate in 2000. The Board does not approve any subsequent ROE adjustment for the remaining term of this trial PBR plan. The Board has treated debt related adjustments similarly.

The Board accepts Union's proposal to change methodology for estimating unaccounted-for gas ("UFG") noting that in a period of increasing UFG, the proposed method would lead to lower accumulations of UFG variances.

The Board approves the 6% pricing flexibility as requested for the purposes of harmonizing Rate M4 and Rate 20.

While the Board has not approved Union's service basket design and associated pricing flexibility proposal, the Board has allowed with some qualifications, including long-term fixed prices and negotiated rates, market-priced storage and introduction of new services, which will allow Union greater latitude than it previously had in managing the utility operations.

In order to monitor and evaluate the operation of utility under the trial price cap plan, the Board finds that filing requirements with respect to actual financial results and revenue-to-cost ratios on a rate class basis are appropriate.

The Board establishes an earnings sharing mechanism, effective from 2001, which is symmetric, based on actual earnings, with a deadband around the Board-approved ROE (that is reset annually on the basis of the Board's ROE adjustment formula) of one percentage point after taxes, and sharing of any earnings variance outside the deadband on a 50:50 basis.

The Board has approved Union's proposal for an off-ramp that would be invoked in the event that Union experiences serious financial difficulty. The Board also found that there should be a symmetric off-ramp invoked if earnings were to unduly exceed the Board-approved target ROE. The Board will monitor the reports submitted by the Company to determine whether this off-ramp is triggered.

Parties generally accepted the service quality indicators ("SQIs") and standards that had been proposed by Union and therefore the Board has approved the proposed indicators for pipeline system integrity surveys, telephone response, emergency response, and gas utilization infraction. The Board has agreed with Union that the development of SQIs related to service access and conduct for retail energy marketers would be more appropriately addressed after the Board issues its Gas Distribution Access Rule.

The Board has approved the continuation of the existing demand side management arrangements including the Lost Revenue Adjustment Mechanism. The Board however has denied the request for an Shared Savings Mechanism.

Most of the unbundling issues were settled by parties to the ADR and this settlement was accepted by the Board. With respect to the remaining unbundling issue, the allocation of upstream transportation, the Board has approved Union's vertical slice proposal for the term of the trial price cap plan. The Board has not however made any finding in this Decision as to the prudency of the components of Union's upstream transportation portfolio.