



**RP-2003-0063**  
**EB-2004-0480**

**IN THE MATTER OF** the *Ontario Energy Board Act*,

**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 commencing January 1, 2005.

**BEFORE:** Paul Vlahos  
Presiding Member

Jan Carr  
Vice Chair and Member

Art Birchenough  
Member

**DECISION AND RATE ORDER**  
**(for rates effective January 1, 2005)**

Union Gas Limited (“Union”) filed an application (the “Application”) dated October 22, 2004 with the Ontario Energy Board (the “Board”) under section 36 of the *Ontario Energy Board Act* (the “Act”) for an order or orders approving or fixing just and reasonable rates for the sale, distribution, transmission, and storage of gas for Union’s 2005 fiscal year commencing January 1, 2005. Union also provided copies of the Application to all intervenors of record in Union’s 2004 rates case. The Board assigned file number RP-2003-0063/EB-2004-0480 to the Application.

## Union's Proposal

Union proposed to adjust rates effective January 1, 2005 to reflect the following changes:

pursuant to the Board's 2004 rates decision, an increase in the fixed monthly charge from \$12 to \$14 for customers served under the Rate 01 and M2 schedules, accompanied by a rate class revenue neutral reduction in delivery charges, over the first three volumetric blocks;

pursuant to the Board's RP-2002-0130 Decision, a reduction in the Delivery Commitment Credit ("DCC") payment to customers providing firm deliveries to Union at a specified delivery point on Union's system from \$2.55/10<sup>3</sup>m<sup>3</sup> to \$1.70/10<sup>3</sup>m<sup>3</sup>;

pursuant to the Board's September 1, 2004 letter, a reduction in the Late Payment Penalty ("LPP") interest charge from 1.9% to 1.5%; and

the elimination of temporary charges and credits that applied to the period May 1, 2004 to December 31, 2004 and the clearing of the 2003 deferral account balances.

Union noted that these proposed changes reflect previous Board decisions or directions. The overall bill impact of these changes on a typical, Southern Operations area residential customer consuming 2,600 m<sup>3</sup> annually would be a \$6 increase per year.

## The Process

On November 4, 2004, the Board issued a Notice of Written Hearing and Procedural Order No. 1 which set out dates for objections to a written hearing, interrogatories, interrogatory responses, submissions by intervenors, and reply submissions by the Applicant. This document was sent to the Applicant and to all intervenors of record in the 2004 Union rates case (file number RP-2003-0063). In response, the Board received letters from Pollution Probe, the Green Energy Coalition ("GEC"), the London Property Management Association and Wholesale Gas Service Purchasers Group

("LPMA/WGSPG"), the City of Kitchener ("Kitchener"), the Industrial Gas Users Association ("IGUA"), and the Vulnerable Energy Consumers Coalition ("VECC").

### **Intervenors' Preliminary Submissions and Union's Responses**

Pollution Probe and GEC requested that the Board hold an oral hearing to test Union's and intervenors' evidence with respect to Union's 2005 Demand Side Management ("DSM") program, budget, volume targets, and associated deferral and variance accounts. Both of these parties noted that Union's current DSM plan will expire at the end of 2004.

LPMA/WGSPG, IGUA and VECC expressed concern over the ratepayers' share of Union's 2003 earnings sharing. Specifically, they disputed the \$12.8 million amount that Union had calculated, as Union subtracted an amount for a weather hedge payment to its counterparty. If the Board did not wish to consider the earnings sharing amount in the instant case, these intervenors argued that the Board should still direct Union to reduce its revenue requirement by \$12.8 million as a partial rebate to customers now, deferring a full review of the issue until a later date. If the Board decides to defer the issue, the Board should direct Union to record the \$12.8 million in a deferral account with interest accruing effective January 1, 2004.

Kitchener also recommended that Union's Application be amended to include 2003 earnings sharing as an issue if its inclusion would not unduly delay 2005 rate implementation. Kitchener also stated its understanding that the absence of disputed rate T3 issues in the instant case would not jeopardize its access to the facilitation process referred to in the 2004 rates decision.

IGUA submitted that it was unclear as to what the appropriate forum was to consider clearance of 2004 deferral accounts and earnings sharing and, as such, requested clarification from Union as to the scope of the current proceeding. IGUA argued that Union's determination of a \$13 million ratepayer credit for 2003 earnings sharing should be viewed as a minimum for two reasons:

Union did not recognize the \$13 million gain from a sale of cushion gas either in Union's 2003 earnings sharing figure or in any gas commodity deferral account,

notwithstanding that Union's shareholder is not supposed to realize gains or losses from commodity sales; and

Union had deducted a \$14 million weather hedge payment as an expense in deriving the earnings sharing figure, a practice that IGUA argued should be disallowed.

IGUA also raised the issue as to whether interest on the ratepayers' 2003 earnings share would begin accruing on January 1, 2004.

By letter dated November 16, 2004, Union stated that its current application responded to previous Board directions and approvals whereas intervenors' concerns dealt with issues that had not yet been addressed by the Board.

Union proposed that the 2005 DSM plan be brought before the Board after the plan has been completed and been reviewed by the DSM consultative<sup>1</sup>.

With respect to the allocation and disposition of 2004 deferral account balances, Union proposed that they be dealt with after the final December 31, 2004 balances are known. Union noted that the Storage Rights Compensation Costs Account, the Late Payment Penalty Litigation Account, and Incremental OEB Costs Assessment Account were all new accounts for which Board review would be necessary to establish the allocation and disposition methodology. Union proposed that this review be undertaken after the 2004 deferral account balances are finalized.

Regarding the issue of 2003 earnings sharing, Union remarked that there was no approved allocation methodology to distribute the balance. Union proposed that the Board deal with this issue at the time a hearing is convened to deal with the issue of deferral account allocations and dispositions.

By letter dated November 17, 2004, IGUA sought clarification from Union with respect to two issues IGUA had raised but on which Union's November 16, 2004, letter was silent: interest on the ratepayers' share of 2003 earnings sharing and the capital gain realized by Union on its 2004 sale of cushion gas. Union replied on November 18, 2004,

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DSM consultative refers to a group consulted by Union on DSM related matters.

confirming that 2003 earning sharing would accrue interest effective January 1, 2004, and proposing that the cushion gas issue be dealt with at the same time as the 2003 earnings sharing and the 2004 deferral account disposition.

### **The Board's November 19, 2004 Decision**

In response to these submissions the Board issued a decision on November 19, 2004, to clarify the scope of issues in the current proceeding and to rule on how to deal with issues raised by intervenors but which were outside the scope of the current proceeding. The Board determined that:

a forum would be convened on a future date to deal with DSM issues, disposition of 2004 deferral and variance account balances, the level and allocation of 2003 earnings sharing, and the treatment of proceeds from sales of cushion gas in 2004;

the facilitation process available to Kitchener from the previous decision would not be affected by Union's current application; and

submissions may be made by parties regarding potential excess utility revenue in 2005.

### **Board Decision**

What follows is the Board's determination of the remaining issues that have been raised by the parties in their final submissions.

#### ***Rates, Cost Allocation and Rate Design***

LPMA/WGSPG, IGUA, VECC and Schools Energy Coalition ("SEC") supported the four rate changes proposed by Union. However, VECC opposed Union's rate rebalancing proposal for the M2 rate class. SEC expressed concern regarding Union's timeline for responding to the Board's directive to study the proposed separation of low and high volume consumers currently within the M2 rate class.

Specifically VECC took issue with the methodology that Union used to decrease delivery rates to offset the increased Rate 01 and M2 fixed monthly charge. VECC noted that in the 2004 rates proceeding, Union had originally proposed to reduce volumetric charges in the first block only. VECC disputed Union's rationale for changing its approach, which was that a change was necessary to reduce the first three block rates to maintain interblock rate differentials and to recognize that some residential customers consumed some second block volumes. VECC submitted that had Union made the volumetric reduction in the first block only, rather than in the first three volumetric blocks as Union has proposed, the typical residential M2 customer would see a bill increase of \$3 per year rather than the \$8 increase under Union's proposal.

Union noted that it modified its original proposal, which was to reduce only the first block volumetric rate, during the 2004 rates proceeding to recognize that not all residential volumes were in the first block and to maintain reasonable interblock rate differentials. Union added that it had provided the rate impacts of its updated proposal by way of undertaking and that the reductions were made in such a way that was revenue neutral for the M2 general service rate class, not revenue neutral for a typical residential customer. Further, the Board approved the modified proposal incorporating rate reductions to the first three volumetric blocks. Union submitted that accepting VECC's proposal would be varying the Board's 2004 rates decision. Finally, Union submitted that although the proposed fixed charge does not recover 100% of customer related costs, increasing the fixed charge better reflected cost causality and hence served to reduce M2 intra-class cross-subsidization.

The Board finds Union's explanations and support for its cost allocation and rate design proposals reasonable and accepts them for purposes of setting rates for 2005.

SEC noted that Union had not yet complied with the Board's direction in the 2004 rates decision that Union undertake a cost allocation and rate design study directed at separating low volume and high volume customers in the M2 rate class and file this study with its 2005 rates application. SEC was concerned that some customers would have to endure "potential misallocation" not only for 2004 but also now for 2005 in the absence of the study. SEC asked the Board to direct Union to complete and file the study when Union files its 2006 rates application, at the latest.

Union submitted that it had not filed its response to the Board's M2 directive because it had not had sufficient time to gather the requisite statistical data and the response to the Board's directive would have to be reviewed in a main rates proceeding. Union expected the data to be available by the end of February 2005 and stated that it intends to hire an expert consultant to assist in the analysis and support of the recommendations.

The Board is satisfied with Union's explanations in this matter. The results of the Board's directive can be deferred to the next main rates case.

The Board therefore approves the rate adjustments for January 1, 2005 as proposed by Union.

### ***Potential Excess Revenue***

LPMA/WGSPG, IGUA, SEC, and VECC recommended that the Board establish an asymmetrical earnings sharing mechanism for 2005, whereby ratepayers would share 50:50 in any excess without a deadband. VECC's preference was for the Board to declare Union's rates interim as of January 1, 2005 and subsequently undertake a cost of service review but stated that the above proposal was an acceptable alternative. The parties submitted that any shortfall in earnings should be entirely to the account of the shareholder. Interest on any ratepayers' share of excess earnings should accrue beginning January 1, 2006. LPMA/WGSPG and VECC suggested that the benchmark rate of return on common equity (ROE) be that last approved by the Board for 2004. IGUA suggested that the ROE be whatever the ROE formula<sup>2</sup> would have generated had 2005 rates been set through the annual review process. VECC suggested that the earnings be weather-normalized. Coral/Superior stated that the Board should ask for information that will allow determination of whether any of the excess earnings are derived from commodity or discretionary gas supply sales.

On Coral/Superior's submission, Union noted that the Board precludes the utility from profiting from the sale of commodity or discretionary gas supply sales services. The Board confirms that this is the case.

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In Guidelines on a Formula-Based Return on Common Equity for Regulated Utilities.

Union argued that the imposition of an earnings sharing mechanism would be a poor precedent for at least three reasons. First, it would be imposed on a utility that was attempting to manage its business without a rate change. Second, it would be imposed less than a year after rates were set following a detailed cost of service review. Third, it would be imposed without any evidence of a risk that material excess revenue was likely to occur. Union suggested the Board could exercise its authority under section 107 of the Act to request financial and other information to enable it conduct its oversight responsibilities. Union also advised in its response that it does not plan to file an application to change rates for 2006.

The Board notes that the timing of Union announcing its intention not to make application for 2005 rates precluded the Board from conducting a review in time for dealing with rates to take effect January 1, 2005. Such notice should have been provided much earlier. In fact, it was as a result of the Board's letter on November 19, 2004 asking Union of its plans that Union formally made its intention concerning 2005 rates known.

The Board accepts Union's position that there is no requirement, legal or otherwise, to file an annual rate application. However, the Board has a responsibility to ensure that the rates charged are just and reasonable. Union is currently under a cost of service regulatory regime. Union's attempt to manage its business without a rate change is laudable but, under cost of service regulation, the Board must also exercise its responsibility in the public interest. Union's argument that the rates were set less than a year ago is of some merit, but that rate setting review did not contemplate a longer time period than the 2004 test year. In the absence of a longer test period review, the Board is concerned with the lack of supporting evidence which would allow the Board to make any reasonable determination on the appropriateness of the revenues that Union projects it will recover in 2005.

The Board finds merit in the suggestions by intervenors. The Board has decided that an asymmetric earnings sharing mechanism with no deadband is appropriate for Union's 2005 fiscal year. The sharing of excess earnings shall be on the basis of a 50:50 split between ratepayers and the shareholder. Any under-earnings will be to the account of the shareholder alone. The Board has decided that the determination of any excess earnings shall be done in conjunction with the next main rates proceeding.

In determining the excess earnings, the benchmark ROE shall be determined through the Board's formulaic approach and shall be based on the most recent data that was available and could have been used had a cost of service review hearing been used to determine the new rates for January 1, 2005. Consistent with past practice, any excess earnings shall reflect normalization for weather.

Since the issue before the Board is for 2005 rates only, the Board will defer its response to Union's announcement that it does not intend to apply for 2006 rates.

**THE BOARD THEREFORE ORDERS THAT:**

1. The rate changes set out in Appendix "A" and the rate schedules set out in Appendix "B" are approved effective January 1, 2005. Union shall implement these rates on the first billing cycle on or after January 1, 2005.
2. The rates pursuant to all contracts for interruptible service under Rates M5A, M7, T1, 16, and 25 shall be adjusted effective January 1, 2005, by the amounts set out in Appendix "C". Union shall implement 2005 changes in rates on the first billing cycle after January 1, 2005.
3. Union shall file evidence at the earliest possible time on the matters related to DSM, disposition of 2004 deferral/variance accounts, and the level and allocation of the balance related to the 2003 earnings sharing mechanism so that the Board can convene the appropriate forum for dealing with these matters.

Union currently has an application before the Board for rate changes effective January 1, 2005 due to changes in Union's expected commodity costs under the Quarterly Rate Adjustment Mechanism (QRAM). Since the effective date for that proceeding and the effective date for the instant proceeding will be the same, as a condition of this order the attached rates shall be superceded by the rates attached to the QRAM decision. No separate customer notice will be required as a result of the instant Decision.

Intervenors eligible for cost awards shall file their cost statements within 15 days from the issuance of this Decision, Union may file its response within 15 days from that date, and intervenors may respond within 15 days from that date.

ISSUED at Toronto, December 15, 2004.

Signed on behalf of the Panel

Original signed by

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Peter H. O'Dell  
Assistant Board Secretary

APPENDIX "A" TO  
DECISION AND RATE ORDER  
BOARD FILE No. RP-2003-0063/EB-2004-0480  
DATED DECEMBER 15, 2004

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Peter H. O'Dell  
Assistant Board Secretary

APPENDIX "B" TO  
DECISION AND RATE ORDER  
BOARD FILE No. RP-2003-0063/EB-2004-0480  
DATED DECEMBER 15, 2004

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Peter H. O'Dell  
Assistant Board Secretary

APPENDIX "C" TO  
DECISION AND RATE ORDER  
BOARD FILE No. RP-2003-0063/EB-2004-0480  
DATED DECEMBER 15, 2004

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Peter H. O'Dell  
Assistant Board Secretary

APPENDIX "D" TO  
DECISION AND RATE ORDER  
BOARD FILE No. RP-2003-0063/EB-2004-0480  
DATED DECEMBER 15, 2004

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Peter H. O'Dell  
Assistant Board Secretary