Ontario Energy Board

Commission de l'Énergie de l'Ontario

RP-2003-0063
EB-2005-0189

IN THE MATTER OF the *Ontario Energy Board Act 1998*, S.O.1998, c.15, (Schedule B);

AND IN THE MATTER OF the Ontario Energy Board's RP-2003-0063/EB-2004-0480 Decision setting rates for Union Gas Limited for 2005;

AND IN THE MATTER OF a Notice of Motion by Union Gas Limited for the Board to vary its RP-2003-0063/EB-2004-0480 Decision.

BEFORE: Gordon E. Kaiser
Vice Chair and Presiding Member

Bob Betts
Member

Paul Vlahos
Member

DECISION AND ORDER

The Applicant, Union Gas Limited, filed a Notice of Motion dated February 2, 2005 seeking an Order varying, cancelling or suspending certain provisions of a Decision of this Board dated December 15, 2004. Specifically, the following relief was sought,

1. An Order cancelling or suspending that portion of the Order implementing an earning sharing mechanism (ESM) for 2005 until further notice or alternatively,

2. An Order varying that portion of the Order implementing an ESM for 2005;

   (a) to provide that any ESM operate on actual earnings not weather normalized earnings;

   (b) to provide that any ESM operate around a deadband of 1%;

   (c) to provide that any ESM operates symmetrically both above and below the 1% deadband;

   (d) to specify a benchmark ROE for any ESM of 9.63% based on the October Consensus interest rate forecast which is the last interest rate forecast that would have been available to set rates prospectively for January 1, 2005; and

   (e) to provide,

      (i) that the existing earning sharing mechanism for Union's storage and transportation transactional activity is suspended in favour of a global ESM of 50/50; or

      (ii) that the existing storage of transportation deferral account margin is excluded from revenue for the purpose of the ESM.

This Application is brought pursuant to Section 21.2 of the Statutory Powers and Procedures Act which provides that "a tribunal may if it considers it advisable and if its rules made under Section 25.1 deal with the matter, review all or part of its own decision order, and may confirm, vary, suspend or cancel the decision or order." This Board's Rules of Practice and Procedure contemplate such a process in Rules 42 to 44.

For reasons which follow, the Board is not prepared to set aside or vary the Decision of December 15, 2004.

Background

On October 22, 2004, Union Gas filed an application, RP-2003-0063/EB-2004-0480, with the Board under Section 36 of the *Ontario Energy Board Act* to implement 2005 rates on January 1, 2005. The application included a draft Rate Order, with supporting working papers. Four different rate changes were contemplated. The Board issued Procedural Order No. 1 on November 4, 2004 calling for submissions from interested parties.

On November 19, 2004, the Board issued a further Decision dealing with certain procedural matters. In that Decision, the Board noted Union's statement that it did not intend to apply for any other changes to 2005 rates other than changes associated with the Quarterly Rate Adjustment Mechanism. This led the Board to issue the following direction:

> "In addition to all the above, an outstanding issue in the Board's view is the potential presence of material excess revenue in fiscal 2005 since the 2005 revenue requirement was not considered when setting the current rates. As part of the submissions stage set out in Procedural Order No. 1, the Board wishes to receive input from the parties as to what options, if any, should be considered by the Board in dealing with this issue."

With the submissions process being completed on December 10, 2004, the Board issued a Decision on December 15, 2004 approving the requested rate changes. The Board noted that it has received submissions from interested parties with respect to the mechanisms to deal with potential excess revenues in fiscal 2005. The Board concluded at page 8 of the December 15 Decision:

> "The Board has decided that an asymmetric earning 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 rates proceeding. In determining excess earnings, the benchmark ROE should be determined through the Board's formulaic approach and should 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 should reflect normalization for weather."

It is this Decision that Union seeks to set aside or in the alternative to modify.

Standard of Review

Counsel for the Industrial Gas Users Association stated that the Board should only vary or cancel an Order of a previous Panel in unusual circumstances. In the Enbridge decision of October 10, 2003, RP-2003-0048, the Board stated:

> "The Board agrees with the submissions made by the CAC that regulatory agencies should not review and vary their decisions except in unusual circumstances."

In this case, the Board has allowed the Applicant to proceed and make detailed submissions with regard to the rationale for the ESM and the various conditions related to it, notwithstanding the fact that the Applicant had full opportunity to address those matters in the earlier proceedings. In the specific circumstances of this Decision , the Board recognized that confirmation or clarification might be helpful.

Should the Board have Imposed an ESM on the Applicant?

The Applicant does not question the jurisdiction of the Board but argues that there were better and more appropriate remedies to address the problem the Board faced. That problem needs to be set out clearly.

The Board had previously set 2004 rates based on 2004 cost of service calculations. At the time, there was no suggestion that Union would not be applying to the Board for 2005 rates. Accordingly, no attention was devoted to that matter.

Later, it came to the attention of the Board that Union would not be applying for 2005 rates. There is some dispute as to when Union notified the Board. This panel does not consider that to be material.

The practical problem is how to protect the ratepayers if it ultimately became apparent that there were over-earnings. The existing rates are final rates and they continue until altered by the Board. None of the parties dispute this. Nor do any of the parties dispute

the fact that the Board is charged with fixing just and reasonable rates and that this means balancing the interests of the utility shareholders and the ratepayers.

Some mechanism is therefore necessary to create what in effect would be a rate adjustment if over-earnings are ultimately determined in a future proceeding. This issue becomes even more important in light of the subsequent statement by Union that it does not intend to apply for 2006 rates. The 2006 issue will be addressed separately.

One option suggested by an intervenor was to declare the 2004 rates interim for 2005.

Another possibility is that the Board could require Union to file a rates application. The Board could commence a proceeding on its own motion under Section 19(4) of the Act and then under Section 21(1) of the Act require the preparation of evidence. Under the Section of 36(7) of the Act, the burden of proof to establish that rates are just and reasonable continues to lie with the utility.

The third possibility is the one proposed by the Applicant. That was that the Board should conduct financial investigations pursuant to Sections 107 and 108 of the Act. Under those sections, an inspector appointed by the Board would have the authority to require the Applicant to produce documents, records, or information. The Applicant argues that these sections give the Board adequate power to ensure that there is no over-earning.

The problem with the third option is, as pointed out by the intervenors, that this is a confidential process. At most, it could be used as a vehicle to make a determination as to whether the Board should force the Applicant to file an Application pursuant to the Sections referred to above. Such a process would be time consuming and impose significant regulatory costs on all parties; and more importantly, it has the disadvantage of being non-transparent.

The Decision of the previous Panel on this matter did not discuss the interim rate proposal in any detail. This Panel has considered this option and concluded that interim rates may not be in the utility's interest. There is a view that interim rates creates uncertainty that is not welcomed by the investment community. Also, interim rates, by their very nature, may involve retroactivity. It is this Panel's view that if the objective of

balancing the interests of the utility's shareholder and customers could be achieved, in the circumstances, through a method other than interim rates, it should be preferred.

This Panel accepts the findings of the earlier Panel. In the circumstances, the use of an ESM was the most practical way to determine just and reasonable rates, absent of any evidence with respect to year 2005. It is admittedly, as one of the intervenors stated, rough justice. Whether it could work for more than one year will have to be considered in a separate proceeding.

Should the ESM operate on actual earnings?

The Applicant argues that the ESM should operate on actual earnings. The intervenors generally argued that the ESM should operate on weather normalized earnings because the effects of weather has always been a risk borne by the shareholder. This Board in its decision of December 15, 2004 held that weather normalized earning should be used.

The Applicant referred to a previous decision of the Board where actual earnings were used for Union in calculating an ESM.[1] That decision dealt with the Applicant's three year Performance Regulation Plan, not the situation that is before the Board in this Motion. The Board's decision in the Enbridge RP-2003-0048 case[2] is more relevant because it too dealt with rates for a post PBR plan. In that case, the Board varied its original decision specifying actual, in favour of using weather normalized results in earnings sharing calculation.

The Panel finds that weather normalizing is the correct approach in this case. The risk of weather has always been borne by the shareholder and, in the absence of a longer term mechanism in place, earnings sharing on the basis of weather normalization is consistent with common regulatory practice and the Board's recent decision in the case of Enbridge.

Should the ESM operate symmetrically?

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[1] Decision With Reasons, *Union Gas Limited*, RP-1999-0017, July 21, 2001, paras. 2.551 to 2.558.

[2] Decision and Order, *Enbridge Gas Distribution Inc.*, RP-2003-0048, October 10, 2003.

The Applicant claims that the ESM should operate symmetrically. That is, the shareholder and the ratepayer should share equally the benefits of any over-earnings and any losses from under-earnings. The intervenors all state that the ESM should operate asymmetrically which is to say that any under-earnings should be strictly borne by the shareholder. This Board in its December 15, 2004 decision concluded the ESM should operate asymmetrically.

This Panel finds that the ESM should operate asymmetrically. The rationale, which highlights key difference from other situations, is that the utility has chosen, for reasons solely within its knowledge, not to file a rate application. As pointed out by the intervenors, the utility has the knowledge and has made this decision based on that knowledge. Only the utility can influence the earnings outcome, and therefore only the utility should face the downside risks of under-earnings. The ratepayer should not face any risk associated with under-earnings.

The Applicant says an asymmetrical ESM will create inappropriate and unnecessary incentives for the utility to file rate applications to protect against the under-earning risk. The Panel does not agree with this assessment. It is true however, that an asymmetrical ESM will cause the utility to not make these decisions capriciously. What would be worse would be a situation where the utility, by deciding not to make application, would be protected on both the upside and the downside.

Should the ESM operate around a deadband?

The Applicant argued that the ESM should operate around a deadband of 1%. The only real logic offered is that in a previous case where Union had an ESM, there was a deadband.[3] Accordingly, it was argued that a deadband in this case should be consistent with past practice. However, there is a previous Enbridge decision where the ESM used did not include a deadband.[4] The Board has already discussed the relevance of the two decisions in the context of its earlier discussion regarding earnings sharing.

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[3] Decision With Reasons, *Union Gas Limited*, RP-1999-0017, July 21, 2001, para. 2.556.

[4] Oral Decision, *Enbridge Gas Distribution Inc.*, RP-2003-0048, September 4, 2003, Tr. Para 67.

The fact remains that there is little logic for a deadband in this case. A deadband may make sense in a PBR case but this ESM is a simple mechanism to deal with the distribution of any over-earnings that are ultimately determined. There is no evidence on this record of any productivity gains or improvements to be achieved through a deadband. This is not a case where we are evaluating the materiality of an over-earning and therefore the band within which excess earnings will be not be shared. This is a simple calculation to provide ratepayers with some relief if it is ultimately determined that the utility's decision not to file a rate application operates to their detriment. Accordingly, this Panel agrees with the Board's earlier Decision that there should be no deadband.

The Benchmark Return on Equity ("ROE")

The Applicant, in its Notice of Motion, asks the Board to specify a benchmark ROE for any ESM of 9.63% based on the October Consensus interest rate forecast, which is the last interest rate forecast that would have been available, to set rates prospectively for January 1, 2005. This Board, in its December 15 Decision, stated only that;

> "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."

The Applicant states that it wanted to clarify the data to be used to avoid future disputes. The Applicant says that the October forecast is the last data that could have been available in order to set rates non-retroactively on January 1, 2005. The Applicant included in the Record the October 2004 Consensus forecast. If that data had been used in the calculation, a benchmark return on equity of 9.63% is generated. The Board accepts the specificity of a 9.63% ROE for 2005.

Should the existing earning sharing mechanism for Union's storage and transportation be suspended in favour of a new ESM of 50/50?

Union currently uses its storage and transportation assets to capture incremental revenue from parties other than its franchise customers. Under the current treatment, that incremental revenue is shared 75% to the ratepayer and 25% to Union. The December 15 Decision was silent in this matter. Union noted that including the earnings

from this revenue source could lead to sharing-on-sharing, or double-counting. The Panel agrees.

These earnings from storage and transportation assets, and the deferral account to which it relates, should not be included in the earnings calculation into which this ESM is applied. All of the parties appear to be in agreement with this approach. This was not an issue that was argued before the previous Panel. This is clarification sought by the Applicant in this proceeding.

Conclusion

For the reasons outlined, the Applicant's motion to set aside or vary the Board Decision of December 15, 2004 is dismissed. The clarifications of the Order requested are granted on the terms outlined.

This leaves the issue of 2006 rates. As indicated, Union has now advised that the company does not intend to file a rate application for that year. Counsel for the Applicant was asked what procedure his client was proposing for 2006. The response was that Union would like to see the Decision in this case first. That is reasonable. The Board expects the Applicant to advise the Board of its position and to notify the parties of record in this proceeding.

THE BOARD ORDERS THAT:

1. The Motion of the Applicant, Union Gas Limited, to cancel or vary this Board's Decision of December 15, 2004 is dismissed, subject to the specification and clarification described in paragraph 2.

2. The Board's Decision of December 15, 2004 is modified to specify that the rate of return on common equity for 2005 is 9.63% and the previously approved incremental revenue sharing for storage and transportation transactional activities is separate from, and not to be included in, the more general earnings sharing.

3. The Applicant will advise the Board within 30 days as to how it intends to proceed with rates for 2006, including its proposal for an earnings sharing mechanism.

4. The Applicant will pay the costs of the intervenors appearing on the Motion, costs to be determined and taxed in the usual fashion.

DATED at Toronto, March 18, 2005.

ONTARIO ENERGY BOARD

Original signed by

Peter H. O'Dell
Assistant Board Secretary