



EB-2008- 0220

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.

BEFORE: Pamela Nowina
Presiding Member and Vice Chair

David Balsillie
Member

Paul Sommerville
Member

DECISION WITH REASONS

INTRODUCTION

Union Gas Distribution Inc. ("Union") filed an Application on September 26, 2008 with the Ontario Energy Board ("Board") under section 36 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15, (Sched. B), as amended, for an order of the Board approving or fixing rates for the distribution, transmission and storage of natural gas, effective January 1, 2009.

The Board assigned file number EB-2008-0220 to the Application and issued a Notice of Application dated October 27, 2008.

The Board granted intervenor status to the Consumers Council of Canada (“CCC”), the Industrial Gas Users Association (“IGUA”), the Energy Probe Research Foundation (“Energy Probe”), the Vulnerable Energy Consumers Coalition (“VECC”), the School Energy Coalition (“SEC”), the Association of Power Producers of Ontario (“APPrO”), the Ontario Association of Physical Plant Administrators (“OAPPA”), Ontario Power Generation, Sithe Global Canadian Power Services Limited, Jason Stacey, Ontario Energy Savings L.P., TransCanada Pipelines Limited, TransCanada Energy Limited, the London Property Management Association (“LPMA”), Kitchener Utilities (“Kitchener”), Canadian Manufacturers and Exporters (“CME”), Direct Energy Marketing Limited, ECNG Energy L.P., Enbridge Gas Distribution Inc., and Hydro One Networks Inc.

On November 28, 2008 the Board issued Procedural Order No.1 which set the dates for the filing of interrogatories, interrogatory responses, submissions and argument for the written proceeding.

On December 10, 2008 Union filed a Notice of Motion seeking an order declaring Union’s rates interim effective January 1, 2009 on the basis that the proceeding timetable did not contemplate the Board’s issuance of a 2009 rate order in time for January 1, 2009 implementation. On December 16, 2008 the Board issued an order making Union’s rates in effect as at January 1, 2009 interim.

THE APPLICATION

Union said that the rates proposed under the Incentive Rate Mechanism (“IRM”) for 2009 were determined in accordance with the Board approved EB-2007-0606 Settlement Agreement and Addendum (collectively the “Settlement Agreement”). The topics covered in Union’s evidence included the 2009 Inflation and Productivity Factors, Y and Z factor Adjustments, Average Use Adjustments and Annual Adjustments to General Service Monthly Charges as defined in the Settlement Agreement

Union’s proposals and requested approvals included:

- An increase of \$1.00 in the monthly fixed charge (from \$17.00 to \$18.00) for the residential classes M1 and Rate 01 on a revenue neutral basis;

- A specification that under Delayed Payment the monthly late payment charge of 1.5% equates to an effective annual interest rate of 19.56%;
- Maintenance of existing deferral/variance accounts;
- Unchanged miscellaneous non-energy charges;
- Y factor amounts of \$1.84 million for DSM and \$5.351 million for the reduction in the in-franchise ratepayers share of long-term storage margins;
- General Service class Average Use of Gas adjustments for 2009;
- 2009 Inflation Factor of 1.54% and a 1.82% productivity factor used to calculate the proposed rates; and
- Z factor adjustment of the costs associated with the conversion to International Financial Reporting Standards (“IFRS”) for recovery in rates.

Union also noted in the Application that it had filed a motion for review and variance of the Board’s EB-2007-0606 decision, dated July 31, 2008, related to treatment of tax changes and risk management. The Board heard the Motion, under docket EB-2008-0292, and issued its decision on December 10, 2008. Union, in its Argument-in-Chief dated December 19, 2008, recognised that the proposed 2009 rates, as originally filed, would have to be adjusted downward to reflect the Board’s decision.

Subsequent to the filing of interrogatory responses, Union, by way of a letter dated December 18, 2008, advised the Board that its proposed Average Use adjustment was in error. Union confirmed that the draft rate order which Union will file following the Board’s decision will incorporate the correct calculation.

THE ISSUES

CCC, SEC, IGUA, CME, Board Staff, APPrO, LPMA, Kitchener and VECC filed submissions. Except for the following, the submissions accepted Union’s evidence or remained silent on non-contentious matters.

Parties questioned Union's proposed Z factor treatment of IFRS costs. Union described the conversion to IFRS as a Canadian Accounting Standards Board requirement that all publicly accountable enterprises adopt IFRS in place of Canadian Generally Accepted Accounting Principles. Union forecasted the conversion costs (pre-tax) to be \$1.511 million in 2009, \$1.510 million in 2010, \$.691 million in 2011 and \$.497 in 2012. For the most part, the intervenors took issue with the appropriateness of using forecasted rather than actual costs and the assertion that the \$1.5 million Z factor threshold was met each year.

Other issues raised by intervenors included Union's reluctance to file the schedules pertaining to its 2007 actual financial results as required by the Settlement Agreement and Union's failure to implement the Board's direction in EB-2008-0304 decision to reduce 2009 rates by \$1.3 million. In EB-2008-0304 Union sought the Board's leave for a proposed transfer in controlling interest and reorganization.

IGUA and CME also asked Union to comment on and explain Union's treatment of TransCanada Pipelines' new "Dawn Overrun Service-Must Nominate ("DOS-MN"). DOS-MN was described as a cheaper transportation service. IGUA and CME questioned why Union considered DOS-MN as related to Storage and Transportation Revenue rather than Upstream Transportation. Under the Settlement Agreement, Upstream Transportation costs are considered as Y factor adjustment items, and, as such, their cost impact flows through to rates. In instances when Upstream Transportation costs decrease, ratepayers would benefit, and, correspondingly, ratepayers would bear the costs when the costs increase. Under the Settlement Agreement variances in Storage and Transportation Revenue items do not flow through to rates.

Board Findings

International Financial Reporting Standards

Union is proposing Z factor treatment of IFRS costs. On this basis, Union is seeking to recover in rates, starting in 2009, the revenue requirement impact of the costs Union forecasts to incur associated with the transition to IFRS. The forecasted conversion costs are summarized in Table 1.

Table 1: IFRS Conversion Costs

| (in millions) | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|---------|----------|----------|---------|---------|
| Capital Investment | \$.592 | \$ 1.334 | \$.263 | - | - |
| Annual Carrying Cost * | \$.086 | \$.363 | \$.581 | \$.595 | \$.497 |
| Operating & Maintenance | \$.882 | \$ 1.148 | \$.929 | \$.096 | - |
| Total Annual (pre-tax) Cost | \$.968 | \$ 1.511 | \$ 1.510 | \$.691 | \$.497 |
| * comprised of depreciation and interest | | | | | |

Source: Exhibit A-1 p6 table 1

Union indicated, in its response to interrogatory B5.1, that the forecasted Operating and Maintenance costs include expenses for consulting, additional staff, project management administration and audit fees. A component of the consulting and the project management expenses will be shared equally with Union's Canadian affiliate, Westcoast. In this regard, Union stated that its share of the costs in 2008, 2009 and 2010 would be \$.0578 million, \$.222 million and \$.0788 million respectively, which are subcomponents of the OMA.

Parties, for the most part, questioned the appropriateness of Union's proposed Z factor treatment for three reasons. First, costs were being claimed for recovery in years where the annual costs did not meet the \$1.5 million Z factor threshold. Second, the amount proposed for recovery was based on forecasted rather than actual costs. Third, when the annual threshold was exceeded, it was by a small amount. These three concerns highlighted the need to examine the forecasted cost components, including timing, and the basis of any cost sharing with Union's affiliates. In the event that the Board approved Union's proposal, many parties advocated the establishment of a variance account to capture differences between forecasted and actual costs.

In order to succeed in its proposal, Union must demonstrate that its claim for Z factor treatment conforms with the terms of the Settlement Agreement of January 3, 2008. Section 6 of that Settlement Agreement defines the criteria that govern consideration of Z factors. Most notably for our consideration of Union's proposal is the requirement that:

"...the cost increase/decrease meets the materiality threshold of \$1.5 million annually for Z factor event (ie. the sum of all individual items underlying the Z factor event)."

There are two components of this definition which are directly relevant to Union's proposal.

First is the requirement that the Z factor is to be considered on an annual basis. Union's proposal would extend Z factor treatment of expenses associated with IFRS transition to 2009, 2010, 2011 and 2012. In the Board's view it is premature to consider the application of Z factor treatment to any cost increases associated with IFRS transition to any year beyond 2009. If Union believes that Z factor treatment is appropriate for 2010, or any of the other years of the IRM plan, it must make application year by year.

Second is a requirement that the cost increase or decrease meet the materiality threshold of \$1.5 million. In this case Union has asserted that the costs associated with the transition to IFRS accounting methodology in 2009 would amount to barely \$11,000 over the materiality threshold of \$1.5 million. This is a very slender margin.

In advancing a claim for Z factor treatment for a category of increased cost, the Board expects an applicant to provide convincing and compelling evidence supporting the proposal. Of course the most compelling evidence for Z factor treatment is the actual expenditures associated with the category of expense. That is not available here. Instead Union has provided forecast costs associated with the transition. Although Union's evidence stated that Ernst and Young LLP ("E&Y") assisted in the development of the forecast, Union did not provide any documentation authored by E&Y in its evidence.

The forecast also includes the proposed 50/50 split of some of the associated cost as between Union and its relevant affiliate Westcoast, discussed earlier. Union's evidence outlined the rationale for the 50-50 sharing of these costs based on the assets of the companies involved. Although these shared elements are small, we note that the extent to which the annual threshold is exceeded is less than these amounts. This may be a reasonable method to allocate the costs. However, due to the absence of any detailed evidence on the nature of the costs, the Board cannot determine if the allocation is appropriate.

In the Board's view, Union has not provided convincing and compelling evidence in support of its claim for Z factor treatment. Given that its proposal is based exclusively

on forecasts of costs it is incumbent upon the applicant to provide as full and as convincing a record as possible supporting these forecasts. It is a meaningful burden, which reflects the extraordinary nature of Z factor treatment and is coloured in part by the very slender margin by which Union's own projection exceeds the threshold.

Accordingly the Board denies Union's application for Z factor treatment for the costs associated with the transition to IFRS accounting.

Given this finding, it is unnecessary for the Board to consider any other ground urged upon it by the intervenors which may have the effect of disqualifying Union's proposal.

Implementation of the Board's Decision in EB-2008-0304

Under docket EB-2008-0304, Union had applied to the Board for leave to transfer the voting shares of Union to a limited partnership, contemplated as a Nova Scotia unlimited liability company, the entire interest in which would be held by Westcoast Energy Inc. In the decision approving the re-organization, the Board made the approval subject to the condition that Union's rates will be reduced effective January 1, 2009 to reflect \$1.3 million in savings related to the redemption of preferred shares that had been identified in the proceeding.

A number of intervenors in this proceeding submitted that Union had failed to follow this direction and that Union's proposed 2009 rates should be adjusted to reflect this ratepayer credit. Union responded that since it had filed a Motion to vary the EB-2008-0304 decision, it would be inappropriate and premature to implement any rate change concerning the \$1.3 million in savings.

The Board acknowledges that Union has filed a motion for the review and variance of the Board's EB-2008-0304 decision. The Board has assigned file number EB -2009-0022 to this motion. The Board also acknowledges Union's earlier correspondence which indicated that the reorganization underpinning the Board's decision and which gave rise to the requirement that a \$1.3 million reduction in the revenue requirement be reflected in the 2009 rates has not been implemented.

However, as of the date of this decision, the Board's order requiring the reduction in revenue requirement for 2009 rates stands. Accordingly, the 2009 revenue requirement

should reflect that reduction unless and until a decision in the motion to vary has been rendered displacing or altering it.

The Board will make every effort to ensure that the motion to vary is considered as expeditiously as reasonable. It is our expectation that the motion can be considered and disposed of prior to the approval of the rate order reflecting 2009 rates. In that case the Board would seek to reflect in the rate order any variance arising from Union's motion.

The Filing of 2007 Financial Information

In its submission, IGUA objected to Union's reluctance to file 2007 actual financial information. The Settlement Agreement referenced above provided for the filing of a variety of materials by Union through the course of the IRM plan. The Board considers the informational filing requirement to be a key element of the Settlement Agreement and the IRM framework. The specific dispute highlighted by IGUA concerns the position taken by Union that because the Settlement Agreement requires it to file information arising "during the IR plan", that 2007 financial information does not qualify.

The Board considers Union's position to be inconsistent with the spirit of the Settlement Agreement and contrary to a reasonable application of its terms. Accordingly, the Board directs to Union to file by April 1, 2009, as part of the materials mandated by the Settlement Agreement, 2007 actual financial information.

Upstream Transportation Changes

Union noted that pursuant to the Settlement Agreement ratepayers were credited with a fixed amount reflecting a forecast performance of its transactional services business. Union also noted that the increased capacity that is associated with the Dawn Overrun Service may have benefits for ratepayers pursuant to the earnings sharing mechanism that continues in place. In other words, ratepayers have been already credited with an amount intended to reflect the transactional services activity of the company. Any additional revenues which may be occasioned by the new TransCanada service will not accrue under this heading, but may lead to earnings sharing distribution.

The Board finds Union's explanation with respect to this concern, which was raised by IGUA in its submissions, to be convincing. In the Board's view this is a fair approach

that is consistent with the general architecture of the IRM plan and the Settlement Agreement.

IMPLEMENTATION

Given current timing, the Board anticipates that the 2009 rates, effective January 1, 2009, will be implemented commencing with the first billing cycle on or after April 1, 2009.

Union is directed to file a draft rate order within 7 calendar days of the issuance of this decision. Intervenors shall have 7 calendar days to respond to Union's draft order. Union shall respond within 7 calendar days to any comments by intervenors.

COSTS

A decision regarding cost awards will be issued at a latter date. Eligible intervenors claiming costs should do so as directed below.

The Board hereby directs:

1. Intervenors eligible for cost awards shall file with the Board and forward to Union their respective cost claims within 25 days from the date of this Decision.
2. Union may file with the Board and forward these intervenors any objections to the claimed costs within 32 days from the date of this Decision.
3. Intervenors, whose cost claims have been objected to, may file with the Board and forward to Union any responses to any objections for cost claims within 39 days of the date of this Decision.
4. Filings are to be in the form of two hardcopies and one electronic copy in searchable PDF format at boardsec@oeb.gov.on.ca and copy Union Gas Limited.

Union shall pay any Board costs of, and incidental to, this proceeding upon receipt of the Board's invoice.

DATED at Toronto, January 29, 2009

ONTARIO ENERGY BOARD

Original Signed By

Pamela Nowina
Presiding Member and Vice Chair

Original Signed By

David Balsillie
Member

Original Signed By

Paul Sommerville
Member