Ontario Energy Board

Commission de l'énergie de l'Ontario

Ontario

EB-2007-0606
EB-2007-0615

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, 2008;

AND IN THE MATTER OF an Application by Enbridge Gas Distribution Inc. for an Order or Orders approving or fixing rates for the distribution, transmission and storage of natural gas, effective January 1, 2008;

AND IN THE MATTER OF a combined proceeding Board pursuant to section 21(1) of the *Ontario Energy Board Act, 1998.*

BEFORE: Gordon Kaiser
Presiding Member and Vice Chair

Paul Sommerville
Member

Cynthia Chaplin
Member

DECISION

July 31, 2008

INTRODUCTION

This decision relates to an Application filed by Union Gas Limited ("Union") on May 11, 2007 under S.36 of the *Ontario Energy Board Act* for an Order of the Board approving or fixing a multi-year incentive rate mechanism to determine the rates for the regulated distribution, transmission and storage of natural gas effective January 1, 2008.

On January 3, 2008, the parties reached an agreement on most of the issues in this proceeding and on January 17, 2008, the Board approved that Settlement Agreement (dated January 3, 2008) which included an addendum dated January 14, 2008.

This decision addresses three matters which were not settled: two issues related to taxes and one issue related to risk management.

The first tax issue to be decided is whether a series of tax reductions that will be applicable to Union during the Incentive Regulation ("IR") plan should be passed on to ratepayers through a "Z factor" adjustment. The key consideration is the extent to which changes in tax rates which occur within the term of Union's IR Plan are captured in the national inflation factor, as measured by the Gross Domestic Product Input Price Index for Final Domestic Demand, component of the price cap formula. The second issue respecting taxes is whether an adjustment to Union's 2007 base rates should be made for tax rate changes that became effective in 2007 but were not reflected in the cost forecast underpinning the applied for rates.

The issue with respect to risk management is whether the costs associated with the company's risk management activities should continue to be recovered from ratepayers. This issue is addressed following the tax issues.

TAX REDUCTIONS DURING THE TERM OF THE IR PLAN

The Settlement Agreement provides that during the term of the five-year IR Plan, any rate increases would be limited by a price cap which is a function of the inflation factor, minus a productivity or "X" factor. The parties have agreed on a specific "X" factor and the manner in which the inflation factor is to be calculated. They have also agreed on the qualifying characteristics of the "Z" factor, an additional adjustment which can be made when unforeseen events take place that are beyond the control of Union. Section 6.1 of the Settlement Agreement provides that to qualify for "Z" factor treatment, an event should meet the following criteria:

1. the event must be related to an increase/decrease in cost;

2. the costs must be beyond the control of the Utility's management and not a risk for which a prudent utility would take risk mitigation steps;

3. the cost increase or decrease must not otherwise be reflected in the price cap index;

4. any cost increase must be prudently incurred; and

5. the cost increase or decrease must meet the materiality threshold of $1.5 million annually per Z factor event.

A variety of tax changes were announced in 2007, including reductions in federal and provincial income and capital tax rates and changes in capital cost allowance rates, to be implemented in 2007 and throughout the IR period. The question to be decided is whether the tax changes will work their way through the economy so that they are reflected in the price cap index through the inflation factor. If the changes are not thought to be so reflected, then they qualify for Z factor treatment.

In this proceeding, the value to Union of the tax reductions forecasted to take place during 2008-2012 IR period was estimated at about $80 million.[1] Union says that these tax reductions should not be Z factored or passed on to ratepayers because they will be reflected in the inflation factor. As a result, Union argues, to pass them on to ratepayers in whole or in part, would mean ratepayers benefit twice.

Six major Intervenor groups submitted detailed arguments on this issue, the Consumer Counsel of Canada ("CCC"), the Industrial Gas Users Association ("IGUA"), the Vulnerable Energy Consumers Coalition ("VECC"), the School

[1] This impact includes the impact of tax reductions in 2007 on tax costs in subsequent years. The specific treatment of that aspect is dealt with as a separate issue in the next section.

Energy Coalition ("SEC"), the City of Kitchener ("Kitchener") and London Property Management Association ("LPMA"). The LPMA group also included the Building Owners and Managers Association of Greater Toronto ("BOMA") and Wholesale Gas Service Purchasers Group ("WGSPG").

Enbridge Gas Distribution Inc. ("Enbridge") was also an Intervenor. It supported Union's position on the issue.

All of the other Intervenors opposed Union's position. They claim that the tax reductions will not be wholly incorporated in the inflation factor during the term of the IR plan and therefore should be given Z factor treatment.

Previous Union Decisions

This is not the first time that consideration of the impact of a tax reduction on the inflation factor during an IR Plan has come before this Board. Union raised the same issue in its previous PBR[2] plan which covered the period 2001 to 2003. The issue there was whether the reduction in Ontario income tax for 2001 and 2002 should flow through to ratepayers as a Z factor. In its decision setting the 2000 rates and adopting the PBR methodology (RP-1999-0017), the Board concluded:

> For example, in the case of changes in provincial income taxes, the Board doubts that this will be fully reflected in a Canada wide GDPPI and in any event would be concerned about a time lag involved. (para 2.318).

The Board went on to direct Union as follows:

> The Board directs Union to track the effect of changes in the Ontario Income Tax and to bring forward the cost changes to be considered through the customer review process as an adjustment to rates." (para. 2.318)

Union tracked the tax changes which turned out to be a reduction of $1.57 million for 2001 and $3.85 million in 2002.

[2] PBR refers to "performance based regulation"

In the subsequent case, which set rates for 2002 and 2003 (RP-2001-0029), Union called Professors Jack Mintz and Tom Wilson (as it did in the current case), and their evidence was essentially the same as in the current case. They stated that "attempting to adjust for lags and relative weightings of the Ontario Provincial Income Tax rate changes in GDPPI would add unnecessary complexity and is not possible with any accuracy".[3] They argued that the tax reductions would flow through to GDPPI, a position the Board accepted.[4] The Board concluded:

> There may be instances where a tax change is of such a nature that may warrant treatment as a Z factor. Such a case may arise when a tax change is of such special and unique application to Union that it cannot reliably be expected to be reflected in a Canada-wide index such as GDPPI. (para 5.29)
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> … The Board accepts for now that the changes in the Ontario corporate tax rates are or will be reflected in the GDPPI, and that no Z factor adjustment should be made at this time with respect to the rate schedules currently in effect under the PBR Plan. The income tax changes therefore are to be considered to be captured in the determination of the PCI. (para 5.31)

The Board accepted that tax reductions flow through to the inflation index notwithstanding the possibility of leads and lags.

Union argued in the current proceeding that the panel should treat this prior decision as a precedent. While Union conceded that the prior decision is not binding on this panel, it says the Board should be consistent in its decision making. It is noteworthy however, that the evidence and the position of the parties in that proceeding were different. Paragraph 5.25 of that decision observed:

> Regarding the "lead/lag issue", Union noted that Kitchener, LPMA, and WGSPG accepted its evidence. Union added that there was no evidence on what the lead or lag is or on how one would adjust for it and later reverse the adjustment. Incorporating lag effects, Union

[3] RP 2001- 0029, Exhibit B, Tab 15, para 2 of 2.
[4] RP-2001-0029, *Decision with Reasons*, September 20, 2002

> submitted, would require assessing the impacts of past as well as current tax changes.

Here, there has been detailed evidence regarding the lags. All the Intervenors, except Enbridge, opposed Union with many saying that only 10% of the tax reductions flow through to the index during the term of the IR Plan.

The Quantitative Evidence

A substantial body of quantitative evidence was tendered by various experts. As noted above, Union relied on the evidence of Professor Jack Mintz of the University of Calgary and Professor Tom Wilson of the University of Toronto. Board Staff called Dr. Mark Lowry of the Pacific Economics Group. CCC, VECC and Kitchener called Dr. Robert Loube of Rolka Loube and Salzer Associates. SEC called Dr. George Georgopoulos of York University.

The Union position in this proceeding is similar to the position it advanced in RP-2001-0029 with the same witnesses. However, this case is different in a number of respects.

In this case, the Intervenors chose to call expert evidence that questioned whether the tax reductions that would occur within the IR period, 2008-2012, would all be reflected in the index <u>in that period</u>. Dr. Loube recommended that at a minimum 75% of the corporate tax reduction should be treated as a Z factor, and that, at a maximum, 25% of the corporate tax reduction could be assumed to be reflected the inflation factor. Dr. Georgopoulos posited that prices will not fall to the extent that consumers will get the full benefit of the corporate tax cut. Dr. Lowry, on the other hand, concluded that absent solid evidence that the inflation factor will respond inappropriately to the tax reductions, it would be reasonable for the Board to reject Z factor treatment for any part of the reductions. In short, the controversy in the proceeding is whether it is sufficient to demonstrate that the tax reductions will flow through to the price cap index "sooner or later" or whether it must be demonstrated that they flow through within the exact period covered by the IR plan.

The initial evidence of Professors Mintz and Wilson did not consider the lag between the time the subject tax reductions were effected and their reflection in the inflation factor. The Union witnesses conceded that there would be lags in the manner in which the tax reduction impacted the inflation factor, but argued that if those lags were considered, Union was entitled to consider the tax reductions that occurred in prior periods. These would compensate for the later lags.

The issue is crystallized in the response by Professors Mintz and Wilson to an SEC interrogatory:[5]

> Question:
>
> Please provide your calculation of the reduction in GDPIPPIFDD that can reasonably be expected to arise in each of the years 2007 through 2012 as a result of the announced changes in federal corporate tax rates, federal CCA rates and Ontario capital tax rates, assuming each is implemented as currently scheduled. If you are unable to calculate the impact on GDPIPPIFDD, please explain why, and provide instead your calculation of the annual reductions in CPI (All Items) instead.
>
> Response
>
> Precise calculations of the reduction in aggregate prices from corporate tax reductions on a year-by-year basis are not feasible. The adjustment of aggregate prices over the 2007-2012 period will include the lagged effects of tax reductions implemented before 2007. Furthermore, the adjustment to tax reductions implemented after 2008 may not be fully realized by 2012.

There seems to be little dispute between the parties that ultimately the tax reductions will flow through the inflation factor. It is a question of the relevant period or whether prior period lags should be considered.

The Intervenors pointed out that the Settlement Agreement specifically refers to the impact of tax reductions of $80 million (the in-period tax reductions) not prior reductions. Union responded that the meaning of the Z factor is set out in the Settlement Agreement which states “the increase/decrease must not otherwise

[5] Exhibit E.3.3.8

be reflected in the price index." Union noted there is nothing in the definition in the Settlement Agreement which states when the price reduction has to be reflected, merely that the reduction "must not otherwise be reflected".

The Intervenors also argued that, as a matter of general regulatory principle, consumers should be no worse off under an IR plan than they would be under cost of service regulation. They stated that it is counter-intuitive that at the beginning of the IR period, Union should receive a windfall gain of $80.5 million. As Professor Wilson agreed, the $80 million tax reduction is a windfall gain which was caused by events entirely beyond Union's control and had nothing to do with productivity gains initiated by Union.[6] Under a cost of service regime these cost reductions would flow through to the customer at each cost of service rates application.

In essence, Union asserts that lags should not be taken into account and that the tax reductions will find their way in to the inflation factor and the price cap index ultimately. Alternatively, Union argued that if lags are to be taken into account then prior period lags should be also considered. It is to be noted that there were significant tax reductions in the prior period.

The Intervenors, on the other hand, argued that prior period tax reductions should not be considered and that the tax reductions at issue are those that occur within the specified IR term. If prior tax period reductions are eliminated, they claim that only a fraction of the tax reductions will flow through to the price cap index during the IR term.

Board Findings

This is a difficult question with a large amount of conflicting evidence. But the principles are relatively straightforward. In order for an IR plan to be successful, it is important that the parties believe it is fair at the outset. There is expected to be a large reduction in taxes over the period. It is understandable why the Intervenors are concerned that ratepayers would lose the benefit of an estimated $80.5 million cost reduction at the very outset of the plan. Such a reduction would clearly enure to the benefit of ratepayers if the company were subject to cost of service regulation.

[6] Tr. Vol. 4, p. 65

On the other hand, it is accepted by all of the experts that tax reductions operating generally within the national and the provincial economies will flow through to the inflation factor over time. There is no dispute that the tax reductions at issue are of this nature.

The question is when the effect of the reductions will flow through to the inflation factor. This Board in RP-2001-0029 did not require Union to demonstrate that the tax reductions would find their way, in their entirety into the inflation factor within the specific term of the IR plan. This approach has also been adopted by regulators in other jurisdictions including the Federal Communications Commission in the United States[7] and the CRTC in Canada.[8]

In the circumstances, the Board believes that the fair solution is to treat 50% of the tax reductions as a Z factor.

This conclusion recognizes that while tax changes do flow through the inflation factor, this process is subject to some significant lags. We cannot know now the precise structure and form of the rate setting mechanism following this IR period, and therefore we cannot know now whether or how all of the impacts of the tax reductions will flow through to ratepayers after the IR period. This suggests that some sharing during the current IR period is appropriate. While we cannot conclude with any certainty the precise amount of the tax reduction which will effectively flow through the inflation factor during current IR period, the evidence indicates that it will be substantially above zero and substantially less than 100%. Our conclusion is that a 50/50 sharing of the impact of tax changes, as applied to the tax the level reflected in the 2007 Board-approved rates, is a reasonable balance. The approach used in Exhibit E3.1.1 is indicative of how the savings are to be calculated for purposes of the sharing.

The Board notes that the 50% allocation was the same solution the parties agreed to in the Enbridge case. That is not the reason for the Board's decision here. We do not treat the Enbridge case as a precedent any more than we treat the RP-2001-0029 decision as a precedent. But it may be some comfort that both gas utilities under the Board's jurisdiction have the same result regarding this particular Z factor.

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[7] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers (1989) 4 FCC Red 2873, 1989 FCC Lexis 860 at para 272; 1990 FCC Lexis 5301 at para 178

[8] CRTC Telecom Decision 97-9 (May 1, 1997) at para 105

THE BASE RATE ADJUSTMENT

Union's 2007 cost of service filing contained certain cost of service reductions relating to income tax. However, other tax reductions, announced later, were not factored into the company's rates. Further tax reductions were announced after Union's 2007 cost of service proceeding with a resulting cost reduction in 2007 of approximately $2.8 million. These cost savings were credited to customers in the Board's decision in EB-2008-0034, dated June 3, 2008. What is in dispute is whether Union's base rates should be adjusted so that the cost reductions over the IR plan arising from the 2007 tax reductions flow through to ratepayers. All of the Intervenors took the position that the tax reductions implemented in 2007 should be incorporated in the base rates before the application of the price cap index.

Union opposed this on the basis that this is an unforeseen test year cost variance which is indistinguishable from many other forecast test year cost variances. Accordingly, Union argued that no adjustment should be made. Union relied on the Board's Natural Gas Forum Report[9] which supports the proposition that a robust base rate setting process should occur in advance of incentive regulation. Union also relied on the evidence of Dr. Lowry (called by Board staff) for the proposition that once base rates are set, the Board should be reluctant to change those rates during the term of the IR plan.

Counsel for IGUA pointed out that these costs are not the product of any efficiencies produced by Union and that the tax changes are matters entirely beyond Union's control. IGUA also noted that the impact of the tax change on 2007 costs is being accorded deferral account treatment.

Board Findings

The Board agrees that as a general proposition, adjustments should not be made to base rates once they are set. However, for the reasons set out above, the Board finds that the 50 % impact during the IR period arising from the 2007 tax reductions should be subject to Z factor treatment.

The Board notes that the tax reductions meet the agreed criteria for a Z factor.

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[9] *Natural Gas Regulation in Ontario: A Renewed Policy Framework*, March 30, 2005

First, the tax reductions are a material cost decrease which impact costs in 2008[10], and throughout the IR period, and is beyond the control of Union's management. Second, as the Board has concluded above, the impact of tax reductions is only partially captured by the inflation factor. The Board concludes that it is appropriate for these tax reductions to be treated in a manner which is consistent with the treatment afforded tax changes which are implemented during the term of the IR plan.

RISK MANAGEMENT

The Settlement Agreement proposed that the Board deal with the Risk Management issue by way of written submission and that no oral evidence was required. The Board received submissions from the Consumer's Council of Canada ("CCC"), the Vulnerable Energy Consumers Coalition ("VECC"), the Ontario Energy Savings Limited Partnership ("OES"), Energy Probe and the City of Timmins. Energy Probe, OES, and the City of Timmins opposed the continuation of the risk management program; VECC and CCC supported the program's continuation.

Union's 2007 Decision

In Union's 2007 rates application (EB-2005-0520) the company maintained that its risk management activities had provided customer benefits in terms of reduced volatility in the magnitude of the rate riders necessary to clear the Purchased Gas Variance Account ("PGVA").

Energy Probe and natural gas marketers opposed the program, noting that the smoothing effect on price volatility impairs competition. The Board, in its decision dated June 29, 2006, rejected this claim, noting that reduced volatility was consistent with its consumer protection objective and that the Quarterly Rate Adjustment Mechanism ("QRAM") and the PGVA processes have as their objective the smoothing of bills and prices. Other intervenors objected on the grounds that it undermined conservations efforts; the Board similarly rejected this argument.

IGUA objected to the program on the basis of its limited efficacy. The Board

[10] The impact of the reduction in costs in 2007 has already been credited to customers as described earlier in this decision.

noted that Union's evidence was that the effect of risk management on the PGVA was modest – and overall bill impact of less than 1%, but a reduction in the range of the PGVA rate riders of about 30%.

The Board concluded that while the QRAM is the main smoothing technique, the risk management program provided additional smoothing at a modest cost. The Board approved the associated O&M costs and the continuation of the program.

Enbridge's 2006 and 2007 Decisions

Enbridge's risk management program has also been the subject of a number of prior Board decisions. A summary of that history is useful for purposes of this decision.

In the decision on Enbridge's 2006 rates (EB-2005-001, February 9, 2006), the Board stated:

> The question that remains is the extent to which Enbridge's risk management program is redundant or represents a useful and cost effective tool to reduce consumer price volatility in a fair and reasonable way…No evidence has been provided that demonstrates whether the hedging activity had a material effect on the volatility experienced by customers, given the effects of QRAM, the PGVA, and equal billing programs over the same period.[11]

Enbridge was directed to prepare evidence related to the volatility experienced by customers resulting from its hedging activities.

In the Enbridge 2007 rates proceeding (EB-2006-0034), the company's evidence was that its risk management activity reduced volatility in the PGVA reference price in the range of $1 and $2 per 10^3m^3. Enbridge noted that risk management was a common activity amongst gas utilities in North America and that the activity had the support of its customers and a recognized expert (RiskAdvisory), as well as past Board decisions.

What was at issue was whether Enbridge had demonstrated that its risk

[11] EB-2005-001 *Decision with Reasons,* February 9, 2006, p.30.

management program had a material effect on the price volatility experienced by customers. The Board in its July 5, 2007 decision found that the program was not of value to customers on the budget billing plan. The Board found that the reduction in the PGVA price volatility was small relative to the prevailing PGVA reference price. The Board noted the large accumulated losses in the program since 2002 and concluded that this was a high cost for customers. The Board also noted the intergenerational impacts of losses and gains in the program, noting in particular the loss of $110 million in 2006. The Board concluded:

> The Company's and Energy Probe's evidence have satisfied the Board that the rate smoothing attributable to the Company's risk management program for the remaining system customers not on equal billing is marginal at best. While the annual costs of operating the program are of lesser concern to the Board, the inter-generational impacts in light of the substantial losses are of significant concern.
>
> Given the program's minimal impact on the other system customers not currently on equal billing, the impact will likely be unnoticed by these customers. For these customers, the option is still available to take advantage of the Company's equal billing plan if they so choose.
>
> For all of the above reasons, the Board directs the Company to cease its risk management program as soon as practical. [12]

The Current Proceeding

Union in the current proceeding explained that its risk management program is unchanged from the program approved by the Board in EB-2005-0520. Union argued that it had been successful in reducing volatility in its gas costs (by 31%) and reducing the volatility in its PGVA. Union's evidence was that the PGVA rate riders were reduced by 14% and the volatility of rate riders was reduced by 17%.

Union also noted that small cost is associated with this program. Over the period 2002 to 2006, the cost was $0.02/GJ or 0.3%. Union noted that the cost of risk

[12] EB-2006-0034 *Decision with Reasons – Phase 1*, [July 5, 2007], p. 46.

management has never exceeded 6% of gas costs in terms of mark to market. The net cost over five years has been $3.4 million.

Union also filed an independent report by Risk Management Incorporated ("RMI") which supports the continuation of Union's risk management activity.

Union submitted that the QRAM and Equal Billing Program perform a complementary function, but are not a substitute for risk management:

> Risk management affects Union's ultimate cost of gas which is passed on to customers. The QRAM and EBP merely smooth customers' bill payments. Generally, the QRAM smoothes the *rate* customers pay while the EBP smoothes the *consumption.* In the event of price volatility induced by either supply or demand fundamental, customers are subject to the price impacts and price volatility irrespective of the QRAM or whether they are on the EBP.[13]

Union noted that only 39% of its customers use the Equal Billing Plan.

Union's evidence was that risk management works to minimize the variance between the QRAM price and the actual gas costs, thereby decreasing the actual size of the PGVA. In Union's view, to the extent that risk management reduces the size of the PGVA, it reduces inter-generational impacts.

Positions of the Parties

VECC and CCC supported the continuation of Union's risk management activity. CCC submitted that the Board has no evidence to contradict Union's position that the program provides value to customers in terms of reducing volatility. CCC further argued that it was premature to eliminate the program before the Board's anticipated broader review of system supply issues.

The City of Timmins submitted that Union and Enbridge should be treated consistently, unless there were extraordinary differences. Timmins also took the position that 6% of total gas costs did not represent a small cost.

[13] Argument in Chief, p. 5.

Ontario Energy Savings L.P. ("OES") also opposed the continuation of the risk management activity, taking the position that there was no material impact on volatility experienced by customers and that the program was contrary to the Board's objectives related to competition, conservation and consumer education. Union replied that there was no evidence of an adverse impact on competition or conservation and noted that these assertions were rejected by the Board in EB-2005-0520.

Energy Probe also opposed this program. It pointed out that while the cost from 2002 to 2006 was $3.4 million, the net loss over the period 2002 to August 2007, excluding administrative costs, is $22.7 million (Ex. JTA.26b). Energy Probe noted that while Union had not experienced the same level of losses as Enbridge, the swing between the positive result in 2003 ($30.4 million) and the negative result in 2006 ($22 million) was over $50 million and that the risk of a significant loss remains. Union replied while there was a loss incurred to the end of August 2007, the objective of the program is not to beat the market and that gains and losses will net out over time.

Energy Probe submitted that the smoothing effect of equal billing far surpassed the smoothing effect of risk management. Customers not on equal billing routinely saw their monthly bill change by between $40 and $60 with risk management. If risk management were eliminated, the maximum monthly bill change for a customer on equal billing would have been $6 when compared to equal billing with risk management.

In Energy Probe's view:

> Union has repeated for years its claim that risk management provides "reasonable value". In fact, risk management has raised the cost of gas and provided slight smoothing effects that are significantly overshadowed by the smoothing effects of QRAM and equal billing. Viewed objectively, there is no value gain for consumers from risk management whatsoever…[14]

Energy Probe concluded that the Board should direct Union to terminate its program and reduce its revenue requirement at the next rebasing to reflect this

[14] Argument in Chief, p. 6.

change.

Union replied that there was nothing new in Energy Probe's arguments, and that the Board had rejected similar arguments in the last Union proceeding. Union reiterated that the evidence is that risk management has had a significant, positive impact on the size and volatility of PGVA rate riders and that there is an incremental benefit even for customers on the equal billing plan.

Board Findings

In its argument Union states "Union's risk management objectives are met through a diversified portfolio of fixed price contracts, indexed price contracts, financial hedging and supply basin diversification." What is at issue, however, is the narrow activity of financial hedging. The other activities, including Union's use of rolling 24 month fixed-price contracts, are in the area of gas supply procurement and are not being considered as part of this issue.

The evidence is clear that the risk management activity reduces volatility in Union's cost of gas, by 31% over the period 2002-2006, at an average cost of 0.3% of total commodity costs. However, the actual mark to market results while netting to $3.4 million over the same period, have ranged from a cost of $22 million in 2006 to a credit of $30.4 million in 2003. What is at issue is whether the benefit to customers, in terms of reduced volatility to them, is sufficient to justify the related expense.

Risk management has reduced the size of PGVA rate riders by 14% and the volatility of those rate riders by 17%. It was on the basis of these impacts that the Board in its prior decision concluded that the program should be maintained. However, the rate rider itself has been less than 10% of the cost of gas.

The Board concludes that although the size and the volatility of the rate rider have been reduced by a material amount when expressed in percentage terms, the impact which is of relevance to customers is best observed through the bill impact. This impact has ranged from -$51.00 to $12.00. However, these are the annualized impacts of quarterly changes, and therefore are overstated from the perspective of customer experienced impact. The greatest impact of -$51.00 (in the March 2003 period) represents a reduction of only $4.25 per month for the quarter in question, and the next largest impact is only a bit over $1.00 per month. Most of the impacts are well below this level.

The Board agrees that in the event of price volatility customers are subject to the price impacts, but the use of the QRAM process and the equal billing plan have the effect of smoothing customer impacts generally in any event. The evidence is clear that the smoothing effect of equal billing alone far exceeds the impact of the risk management program. Union notes that only 39% of customers opt for the equal billing plan. The Board takes this to be a transparent indicator of the level of smoothing desired by customers.

Against this minimal incremental benefit, there are also modest costs. However, these costs have varied between material gains and material losses over the period. The Board understands that on a net basis there should be no gain or loss, however in comparing these swings with the marginal level of benefits, the Board concludes that there is no material net benefit for customers. As a result, the Board will disallow the recovery of the associated costs. The Board will make no consequential adjustment to the company's rates at this time, but Union is directed to record the costs, which are currently embedded in rates for the duration of the IR period, in a deferral account for disposition later. The appropriate adjustments to distribution rates will be considered at the time of Union's next rebasing.

COSTS

A decision regarding cost awards will be issued at a latter date. Eligible intervenors claiming costs that have not already been filed under phases 1 and 2 of the cost claim process for this proceeding should do so as ordered below.

The Board hereby directs:

1. Eligible intervenors claiming final costs are to file their claims by September 22, 2008 in accordance with the Board's Practice Direction on Cost Awards.

2. Union and Enbridge shall have until 14 calendar days from the date the cost claim was filed to object to any aspect of the costs claimed. The party claiming costs shall have 7 calendar days from the date of filing of the objections to file a reply.

3. 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 and Enbridge Gas Distribution Inc.

DATED at Toronto, July 31, 2008.

Original signed by

Gordon Kaiser
Presiding Member and Vice Chair

Original signed by

Paul Sommerville
Member

Original signed by

Cynthia Chaplin
Member