Alberta Utilities Commission

AltaGas Utilities Inc.

2008-2009 General Rate Application Phase I

October 29, 2009

ALBERTA UTILITIES COMMISSION
Decision 2009-176: AltaGas Utilities Inc.
2008-2009 General Rate Application Phase I
Application No. 1579247
Proceeding ID. 88

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Contents

List of Tables

ALBERTA UTILITIES COMMISSION
Calgary Alberta

ALTAGAS UTILITIES INC. | **Decision 2009-176**
2008-2009 GENERAL RATE APPLICATION | **Application No. 1579247**
PHASE I | **Proceeding ID. 88**

1 INTRODUCTION

1. AltaGas Utilities Inc. (AUI or AltaGas) filed under the provisions of the *Gas Utilities Act,*[1] a 2008-2009 general rate application (GRA) Phase I (the Application), dated July 14, 2008, with the Alberta Utilities Commission (AUC or Commission). The Application:

a. requested the Commission's approval of AUI's revenue requirement and rate base for the 2008 and 2009 test years required to serve AUI's customers in a safe, reliable and efficient manner; and
b. responded to outstanding Directions arising out of Decisions 2007-094[2] and 2008-032[3] issued by the Alberta Energy and Utilities Board.[4]

2. AUI updated the Application on October 10, 2008 (First Update)[5] and on March 6, 2009 (Second Update).[6] The First Update was to ensure that the Application was current, complete and accurate based on the best available information to AUI. The Second Update reflected revisions to AUI's forecasts as a result of changes in rates pursuant to Decisions 2008-103,[7] 2009-024[8] and 2009-026[9] and in economic conditions that had arisen since the First Update. The Second Update also included AUI's request for approval to include carrying costs in its rates related to regulatory lag associated with the ultimate approval of its 2008 and 2009 deficiencies or surpluses. In the Second Update AUI forecast 2008 and 2009 revenue deficiencies to be approximately $5.6 million and $3.6 million, respectively, and revenue requirements to be approximately $41.1 million and $45.2 million, respectively. Table 1 compares the revenue requirements forecast for the test years at the various times with allowed amounts and actual amounts for 2007.

1 RSA 2000, c. G-5.
2 Decision 2007-094: AltaGas Utilities Inc., 2007 General Rate Application Phase 1 (Application No. 1494406) (Released: December 11, 2007).
3 Decision 2008-032: AltaGas Utilities Inc., 2007 General Rate Application Phase 1 Refiling (Application No. 1556301) (Released: April 30, 2008).
4 The Alberta Energy and Utilities Board (EUB or Board) was the predecessor to the AUC.
5 Ex. 14.01.
6 Ex. 78.01.
7 Decision 2008-103: AltaGas Utilities Inc., 2007 Deficiency Rider, Interim Refundable Rates and Standard Contribution – Rural Other (Application No. 1575162, Proceeding ID. 64) (Released: October 21, 2008).
8 Decision 2009-024: AltaGas Utilities Inc., 2009 Interim Refundable Rates (Application No. 1598641 Proceeding ID. 145) (Released: February 11, 2009).
9 Decision 2009-026: AltaGas Utilities Inc., 2009 Interim Refundable Rates, Rate Schedules (Application No. 1604809, Proceeding ID. 169) (Released: February 27, 2009)

Table 1. Forecast Revenue Requirements

	2007 Allowed Normal	2007 Actual Normal	2008 Forecast Normal	2009 Forecast Normal	2008 Forecast Normal	2009 Forecast Normal	2008 Forecast Normal	2009 Forecast Normal
			July 14, 2008		First Update		Second Update	
	$000	$000	$000	$000	$000	$000	$000	$000
Operating, Maintenance and Administration Expense	20,479	20,770	24,064	27,195	23,806	26,974	23,806	27,195
Depreciation Expense	9,330	9,330	9,784	10,653	10,050	10,674	9,996	10,653
Amortization of CIAC	(2,219)	(2,219)	(2,274)	(2,245)	(2,274)	(2,243)	(2,274)	(2,245)
Municipal Taxes	64	47	50	50	50	50	50	50
Income Taxes	896	1,103	1,035	-	1,253	-	1,249	-
Return on Rate Base	7,162	7,218	8,273	9,525	8,262	9,616	8,229	9,525
Total Revenue Requirement	35,712	36,249	40,932	45,178	41,147	45,071	41,056	45,178
Reconciliation of Revenue Requirement:								
Delivery Revenue, Existing Rates	34,436	35,030	33,576	40,267	33,576	34,327	34,104	40,267
Other Revenue	1,276	1,344	1,327	1,357	1,327	1,352	1,329	1,357
Total Revenue, Existing Rates	35,712	36,374	34,903	41,624	34,903	35,679	35,433	41,624
Revenue Deficiency (Excess)	-	(125)	6,029	3,554	6,244	9,392	5,623	3,554
Total Revenue Requirement	35,712	36,249	40,932	45,178	41,147	45,071	41,056	45,178

3. On July 18, 2008 the Commission electronically distributed the Notice of Application to parties on the Commission's gas distribution list and posted it on the Commission's website. In addition, on July 22, 2008 the Commission published the Notice in the Calgary Herald, the Calgary Sun, the Edmonton Journal and the Edmonton Sun. The Notice is listed as Exhibit 4.01 in the Commission's electronic proceeding system.

4. The Notice stated that any party who wished to intervene in this Proceeding must submit a Statement of Intent to Participate (SIP) to the Commission by the participation closing deadline of 2:00 pm, August 1, 2008. Parties that filed SIPS were the Alberta Sugar Beet Growers and the Potato Growers of Alberta, AltaLink Management Ltd., the Consumers' Coalition of Alberta, FortisAlberta Inc., the Public Institutional Consumers of Alberta (PICA), and the Office of the Utilities Consumer Advocate (UCA). The Alberta Sugar Beet Growers and the Potato Growers of Alberta and the Consumers' Coalition of Alberta combined their participation as the Consumer Group (CG).

5. The oral hearing for the Application was held in two parts. Part 1, which examined the requested revenue requirement for AltaGas' distribution function for the 2008 and 2009 test years, except for those issues dealing with inter-affiliate shared costs, was held in Edmonton on April 1 and April 2, 2009. Part 2, which dealt with the inter-affiliate shared costs, was held in Edmonton on May 4 and May 5, 2009.

6. Subsections 36(a) and 40(a) of the *Gas Utilities* Act and section 91(1)(a) of the *Public Utilities Act*,[10] section 5 of the *Default Gas Supply Regulation*, and section 4(3) of the *Roles, Relationships and Responsibilities Regulation*[11] provide the Commission with the power to assess just and reasonable rates and to consider all revenues and costs that are in the Commission's opinion applicable. Section 44 of the *Gas Utilities* Act requires prior Commission approval of any changes in existing rates, tolls or charges. The Commission considers that, in order to satisfy the burden of proof of showing that proposed changes in rates, tolls or charges are reasonable, evidence that is satisfactory to the Commission must be presented to justify the costs used in determining the new rates.

7. The panel assigned to the Application was Mr. N. Allen Maydonik, Q.C., (Panel Chair), Mr. Tudor Beattie, Q.C., (Commissioner) and Mr. Mark Kolesar (Commissioner). The Commission set dates of June 5, 2009 and June 26, 2009 for argument and reply argument, respectively. Subsequent to reply argument, AUI filed surrebuttal on June 30, 2009 concerning the introduction of new evidence by UCA. Consequently, by letter dated July 20, 2009 the Commission allowed for additional process to deal with the surrebuttal. As both AUI and UCA submitted final replies on July 31, 2009, for the purposes of this Decision, the Commission considers the record to have closed on that date.

2 BACKGROUND

8. AUI is a wholly-owned subsidiary of AltaGas Utility Holdings Inc. (AUHI), which is a wholly-owned subsidiary of AltaGas Utility Group Inc. (AUGI), a public corporation.[12] AUGI indirectly acquired AUI in a corporate reorganization undertaken by AltaGas Income Trust in 2005 (2005 Transaction).[13]

9. The previous GRA Phase I for AUI, which it filed on December 29, 2006 for the 2007 test period, led to Decision 2007-094. Direction 40 of that Decision required AUI "…to revise its 2007 GRA Phase I to reflect the Board's findings, conclusions and directions in this Decision and to re-file the amended GRA by January 18, 2008."

10. Consequently, on January 18, 2008 AUI submitted the 2007 GRA compliance re-filing, which led to Decision 2008-032. In approving AUI's compliance re-filing, the Commission set revenue requirement for 2007, excluding natural gas commodity costs, at $35.712 million which,

[10] R.S.A. 2000, c. P-45.

[11] *Roles, Relationships and Responsibilities Regulation*, Alta. Reg. 186/2003, subsection 4(3).

[12] AUGI was a public corporation as of the close of record. On October 1, 2009, in Decision 2009-152, the Commission approved AUGI's share transfer and amalgamation application, which would result in AltaGas Income Trust and its affiliates owning 100 percent of AUGI (Decision 2009-152: AltaGas Utility Group Inc., Share Transfer and Amalgamation, Application No. 1605414, Proceeding ID. 295, Released: October 1, 2009).

[13] Decision 2005-112: AltaGas Utility Holdings Inc., Request for Approval of Share Transfer (Application No. 1408750) (Released: October 14, 2005).

based on rates in existence at that time, resulted in a before tax revenue deficiency of $2.286 million. AUI did not file a 2007 GRA Phase II to establish new rates for 2007.

11. On January 30, 2008, AUI applied to the AUC for authority to issue 172,652 common shares for an aggregate consideration of $5 million to AUHI. The AUC authorized the issue of the shares in Order U2008-84.[14]

12. On March 10, 2008 AUI applied to AUC for review and variance (R&V) of Decision 2007-094, alleging that the EUB erred in law or in fact with respect to certain disallowed inter-affiliate costs and material, contractor and other costs. In Decision 2008-079,[15] the Commission denied AUI's R&V.

13. On June 5, 2008 AUI applied to the AUC seeking approval for the collection of the 2007 deficiency, an interim rate adjustment based on the final results of the 2007 GRA, and an adjustment to AUI's non-refundable contribution rate for Rural – Other Services. The AUC approved the application in Decision 2008-103 and directed AUI to make three compliance filings:

- to update the placeholders in the Application for base 2007 billed revenue and the Deficiency Rider by October 27, 2008 [Order (5)];
- to reconcile the forecast and the actual 2007 Deficiency Rider and to provide a recommended method of disposition of any difference by February 28, 2009 [Order (6)]; and
- to update during AUI's 2008/2009 GRA proceeding the current revenue forecast in its 2008/2009 Phase 1 GRA (Application No. 1579247), reflecting the interim rates as they were approved [Order (7)].

14. On October 27, 2008 AUI made its required compliance filing to update placeholders. Consequently, in Order U2008-324[16] the Commission approved for AUI a 2007 Deficiency Rider of 7.882 percent to recover a total of $2.297 million over the billing months of November 2008 through February 2009, inclusive. In addition, the Commission directed AUI:

a. to provide a detailed explanation by December 3, 2008, within its 2008/2009 GRA, of the factors that contributed to the significant declines in its 2007 billed revenues which AUI utilized in calculating its deficiency rider;

b. to file its reconciliation application by June 30, 2009, in order that the most complete billing information is available for review.

15. On December 3, 2008 AUI provided its response to explain the factors contributing to the decline in its 2007 revenue. The response was entered in the Commission's electronic proceeding system for this Application as Exhibit 23.01.

[14] Order U2008-84: AltaGas Utilities Inc., Issuance of Class A Common Shares (Application No. 1558635) (Released: March 27, 2008).

[15] Decision 2008-079: AltaGas Utilities Inc., Decision on Preliminary Question, Review and Variance of Alberta Energy and Utilities Board Decision 2007-094 (Application No. 1564573) (Released: August 22, 2008).

[16] Order U2008-324: AltaGas Utilities Inc., Compliance Filing (Application No. 1592368) (Released: October 31, 2008).

16. On December 10, 2008, AUI applied to the AUC requesting approval for interim refundable rates to be implemented February 1, 2009. AUI requested an increase to all delivery rates of 10.065 percent to recover 50 percent of the 2009 adjusted revenue deficiency of $6.910 million, which represented the deficiency of $9.392 million from the First Update less $2.482 million for the subsequent revenue increase, effective November 1, 2008, allowed by Decision 2008-103. The AUC approved AUI's request in Decision 2009-024, subject to the filing of interim rate schedules by February 18, 2009.

17. On February 20, 2009 AUI filed the interim rate schedules. The AUC approved AUI's interim rates effective March 1, 2009 in Decision 2009-026.

18. In reaching the determinations contained in this Decision, the Commission has considered the record of this proceeding, including the evidence and argument provided by each party. Accordingly, references in this Decision to specific parts of the record are intended to assist the reader in understanding the Commission's reasoning relating to a particular matter and should not be taken as an indication that the Commission did not consider other relevant portions of the record with respect to that matter.

3 RATE BASE

19. In the Second Update AUI forecast its rate base for 2008 and 2009 as follows:[17]

Table 2. Rate Base

	2007 Allowed Normal	2007 Actual Normal	2008 Forecast Normal	2009 Forecast Normal
			Second Update	
	$000			
Gross Plant in Service				
Beginning of Year	249,197	249,197	266,115	283,109
End of Year	262,806	266,115	283,109	311,214
Mid-Year	256,002	257,656	274,612	297,162
Less: Disallowed Plant, Mid-Year	-	-	-	-
Mid-Year Balance	256,002	257,656	274,612	297,161
Accumulated Depreciation				
Beginning of Year	101,372	101,372	107,003	113,915
End of Year	107,569	107,003	113,915	121,654
Mid-Year Balance	104,470	104,187	110,459	117,784
Mid-Year Plant in Service	151,532	153,469	164,153	179,377
Add: Working Capital	2,571	2,548	2,241	2,506
Mid-Year Rate Base	154,103	156,017	166,394	181,883

17 Ex. 78.01.

Less: Mid-Year Contributions in Aid of Construction (CIAC)	49,752	50,851	51,765	52,396
Mid-Year Rate Base Net of CIAC	104,351	105,166	114,629	129,487

3.1 Opening Balances

Views of AUI and the Interveners

20. CG considered that it was standard practice of the AUC and its predecessors to have the forecast closing balances of Property, Plant and Equipment (PP&E) updated for actual PP&E balances. In principle, the updating and replacing of forecast with actual results for those balance accounts which contain continuity schedules such as PP&E, undepreciated capital costs, and deferral accounts, should be no different for the second test year, 2009, than for the first test year, 2008. Therefore, AUI should be directed in its compliance filing to use actual results to update the forecast opening balances for those balance sheet accounts which have continuity schedules.

21. AUI addressed CG's recommendation, and provided its view on Commission process, namely that:

> …the AUC does not substitute forecast information with updated or actual information except in respect of certain specific forecast items which AUI has done.[18]

22. AUI submitted that CG's recommendation to update its opening balances for 2008 with actual results in its compliance filing should be rejected. AUI submitted that the recommendation was inconsistent with the fixed forward test year system of regulation that by its operation addresses the complexities of a multi-test year nature of the GRA Phase 1.

Views of the Commission

23. The Commission agrees with CG, that it has been standard practice for PP&E balances to be updated when actuals become available. The Commission recognizes that these updates may have been made voluntarily by the utilities or as a result of a Commission direction. The Commission notes the views expressed in Decision 2006-024[19] with respect to updates:

> On occasion, the Board has also substituted specific forecast information with the updated actual information. For example, the Board has updated interest rate forecasts in determining the cost of capital, income tax rates, opening balances for plant property and equipment and has excluded amounts forecast for capital projects that did not proceed.[4] In taking this action, the Board had determined that the use of updated information in these particular types of categories was in the overall public interest in order to achieve an appropriate revenue stream without undue benefit or detriment to the regulated utility.[20]
>
> [4] See for example: Decision U97065 1996 Electric Tariff Applications Alberta Power Limited, Edmonton Power Reply Inc., TransAlta Utilities Corporation, Grid Company of Alberta, dated October 31 1997 (opening balances); Decision 2000-9 Canadian Western Natural Gas Company

[18] AltaGas Reply Argument, p. 2, ll. 18-20.
[19] Decision 2006-024: ATCO Electric Ltd. General Tariff Application (Application No. 1399997) (Released: March 17, 2006).
[20] Decision 2006-024, p. 5.

> Limited Phase I, dated March 2, 2000 (risk free rate); Decision 2001-97 ATCO Pipelines South 2001/2002 General Rate Application Phases I and II, dated December 12, 2001(opening balances, income tax rate adjustment); Decision 2003-100 ATCO Pipelines 2003/2004 General Rate Application Phase I, dated December 2, 2003 (opening balances, disallowance of costs for cancelled project, income tax rate adjustment).

The Commission also expressed a similar view in Decision 2008-113:[21]

> The Commission agrees with the Board's comments cited above, and continues to hold that an appropriate balance can be struck which allows for a utility to plan and budget according to its forecasts but that also provides the Commission with sufficient current information to enable it to assess the reasonableness of those forecasts. It is expected that a utility will put forth its best possible case in making an application for its revenue requirement. That best possible case should reflect information available to the utility that may reasonably form part of its Application and any updates thereto.[22]

24. The Commission is of the view that the best information available with respect to 2009 opening balances for PP&E is the actual closing balances for 2008. On this basis, the Commission considers that AUI should update its 2009 opening balance for PP&E. Therefore the Commission directs AUI in the compliance filing to update its 2009 opening balances for PP&E to include the actual closing balance amounts filed for 2008.

3.2 2009 Forecast Capital Expenditures Inflation

Views of AUI and the Interveners

25. Based on updated forecasts for contractor unit costs, increases in unemployment, declines in Consumer Price Index (CPI), the 5 percent contractor inflation rate approved for ATCO Gas in Decision 2008-113, and ATCO Electric's request for 5 percent contractor inflation rate, UCA recommended that the inflation increase for services and mains installed by contractors be limited to an increase of 5 percent in 2009 over 2008 costs. UCA considered that this inflation rate should apply to transmission, system betterment, and general plant projects utilizing external contractors. UCA noted that, in the hearing, AUI indicated that it would not dispute a range for inflation of 5 percent to 5.5 percent.[23]

26. AUI indicated that the 5 percent inflation rate for contractor labour recommended by UCA was consistent with what AUI is now anticipating. Thus, AUI agreed that the 5 percent rate should be used for its 2009 forecast capital expenditures.

Views of the Commission

27. Noting previous rulings with respect to contractor inflation, and the agreement between UCA and AUI, the Commission considers that a contractor inflation rate of 5 percent for capital expenditures is reasonable. Therefore, the Commission directs AUI in the compliance filing to apply a 5 percent inflation rate for contractor costs to arrive at the 2009 forecast capital expenditures.

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21 Decision 2008-113: ATCO Gas, 2008-2009 General Rate Application Phase I (Application No. 1553052, Proceeding ID. 11) (Released: November 13, 2008).

22 Decision 2008-113, p. 16.

23 Tr. Vol. 2, p. 268.

3.3 Capital Expenditures

28. In the Second Update AUI forecast capital expenditures as follows:[24]

Table 3. Capital Expenditures

	2007 Approved	2007 Actual	2008 Forecast	2009 Forecast
			Second Update	
	$000			
New Business				
Rural	3,041	3,051	1,684	1,849
Rural subdivision	1,556	2,201	1,741	1,893
Town	3,054	5,631	4,537	4,913
Meters and regulators	300	607	842	896
Total New Business	7,951	11,490	8,804	9,551
System Betterment	3,770	3,924	5,663	6,340
General Plant	3,287	3,290	9,366	11,906
Costs of Removal	293	406	627	680
Total	15,301	19,110	24,460	28,477

3.3.1 New Business – New Service Connections and Mains

Views of AUI and the Interveners

29. UCA raised three issues with respect to services and mains: the very large increases in the 2008 unit costs for services installed by AUI, the increases in unit and overall land and inspection costs, and the increases in overhead costs. With respect to these three issues, UCA recommended that:

- unit cost increases for services installed by AUI should be limited to the 5 percent in each of 2008 and 2009 over the 2007 approved unit costs,
- 2008 Inspection costs should be based on 2007 Actual Inspection costs of $1,010,000 plus 5 percent for inflation ($1,060,000) and 2009 Forecast Inspection costs should be based on a further 5 percent inflation plus one additional FTE at approximately $75,000 ($1,188,000), and
- overheads should also be reduced, given the reductions to inspection and inter-affiliate shared costs recommended by UCA.

30. AUI did not agree with UCA's recommendation to limit the increases in the unit costs for new services installed by AUI personnel to only 5 percent over 2007 unit costs. AUI advised that it made an accounting change between 2007 and 2008 and asserted there was clear evidence that provides the reason for the significant increases in costs.[25]

31. Absent a full explanation as to the impact of the accounting change, UCA submitted that it was left with the question of why AUI maintains engineering and construction staff that results in unit costs changing from 156 percent to 181 percent from one year to the next as a result of these costs being fixed. UCA submitted that AUI should be directed to provide clear evidence in

[24] Refer to Ex. 78.01.
[25] AUI Argument, pp. 13 and 14.

its next GRA that demonstrates that AUI is maintaining an appropriate base level of engineering and construction staff.

32. AUI submitted that 2007 was an anomalous year for AUI with respect to the number of new service connections and quantity of mains installed, which gave rise to large variances between AUI's forecast and actuals. AUI stated the following with respect to its forecasts for new service connections and mains:

- 2008 new service connection forecast of 2000 was based on a reduction in 2007 actuals with the benefit of first quarter 2008 data; in 2008 actual new service connections were 2056;
- 2009 new service connection forecast was based on its 2008 forecast;
- 2008 forecast of 46,618 meters of mains was based on 2008 being similar to 2006; in 2008, 89,342 meters of mains installed; and
- 2009 forecast for main installation was based on almost a 50 percent reduction over 2008 actual amounts.

33. AUI noted that UCA cited increases in unit costs for services installed by AUI crew labour as increasing between 2007 actual amounts and 2008 forecast by as much as 181 percent in support of its recommendation to limit unit cost increases for services installed to 5 percent in 2008 and 2009. AUI considered that the comparison was neither accurate nor valid as it failed to consider that engineering and overhead costs, which form part of the per unit cost, are fixed. AUI submitted that the change in the number of new service connections and mains does not change these costs as they are not variable. Additionally, AUI disagreed with UCA's comparison between 2007 actuals and 2008 forecast for AUI because unit costs failed to account for the change that AUI made between 2007 and 2008 in allocating overhead in the form of AUI crew labour costs to new service connections. AUI submitted that, in effect, the increases in AUI's unit costs cited by UCA in part represent AUI's labour costs that were previously allocated under "general overhead" and otherwise recovered from rate-payers and that these costs are properly allocated and are recovered appropriately, as noted in response to CCA-AUI-14.

34. UCA also cited increases of 38 percent to 275 percent for land and inspection costs between 2007 actual amounts and 2008 forecast amounts in support of its recommendation to limit increases for inspection costs to a 5 percent increase over 2007 actual amounts, and a further 5 percent increase for 2009 plus the cost of one additional FTE. AUI noted that the increased costs were due to a forecast increase in AUI inspector positions for 2008 and 2009 and that these are fixed costs, independent of any changes in new business or capital expenditures. AUI stated that in 2008 it did not fill the inspection positions included in the forecast. In the absence of these positions being filled AUI either redirects customer service technicians or hires contractors to conduct inspections, leading to additional costs by way of overtime or contractor costs. As these additional costs were not tracked or charged to capital projects, AUI submitted that any comparison of AUI's 2007 actual inspection costs to its 2008 forecast and 2008 actual costs fails to fully account for the actual inspection costs incurred as the inspection positions were vacant in both 2007 and 2008.

35. With respect to land and inspection costs, UCA noted that although AUI asserted the increases in these unit costs related to "staff vacancies in 2007 being filled in 2008," this position was subsequently shown to be incorrect. AUI initially stated during cross-examination that it forecast included filling two positions in 2008 and one position in 2009. However, in its

undertaking to provide the inspection positions that were filled in 2008, AUI indicated that no positions that were vacant in 2007 were filled in 2008. One vacant inspection position was filled in February 2009.

36. UCA also submitted that AUI had rationalized the increased inspection costs in 2008 when it stated "some of AUI's (2007) internal inspection costs were actually charged as direct labor as opposed to inspection. As a result, AUI's 2007 actual Land and Inspection cost is low compared to the forecasts."[26] AUI subsequently admitted that statement was also in error.[27] UCA submitted that since AUI was able to provide the necessary inspection services with the existing staff during 2007 and 2008, it therefore appears that the need to fill three positions without any demonstrated growth was overly optimistic.

37. AUI submitted that the land and inspection and overhead components were fixed costs incurred by AUI regardless of whether or not the capital project was actually completed in the forecast test year. AUI also submitted that once these fixed costs were forecast the amount remains unchanged for the forecast test year and the only thing that may change was the allocation of these costs across the forecast capital projects. The extent that these fixed costs may vary as between forecast and actual would be due to differences between forecast and actual staffing levels that result from unforeseen vacancies and the lag associated with filling positions.

38. AUI submitted that the forecast for land and inspection was reasonable, particularly given that AUI's 2008 forecast for land and inspection relating to capital expenditures was $1,819,900 while its actual amounts were $1,821,132. AUI noted that the difference was less than 1 percent (i.e., no variation existed because these costs are fixed). AUI also noted that its 2008 forecast and actual amounts for overhead were $2,599,245 and $2,784,156, respectively, representing a difference of approximately 10 percent.

Views of the Commission

39. The Commission notes AUI's position with respect to forecasting differences:

> As outlined above, AUI's 2008 forecast for new business was $8,804,100 and its actual capital expenditure for new business was $10,749,411 resulting in AUI spending approximately $1.95 million above forecast. This 22% increase was due primarily to AUI installing 92% more mains than forecast. Despite AUI incurring actual new business expenditures that were $1.95 million in excess of its 2008 forecast, AUI submits that the 2008 forecast amount should be approved by the Commission provided it approves the 2009 forecast as substantially unchanged. This is in keeping with a fixed forward test year approach where approval on a gross number basis can be used to net over spending on capital in one category of capital expenditures via an offset by under spending on capital in another category – for example in 2008 AUI overspent by $1.95 million for new business but under-spent by $1.8 million on system betterment.[28] [footnote omitted]

40. The Commission notes that AUI made reductions in 2008 associated with system betterments due to the significant decrease between forecast and actual results. To be balanced, the Commission considers that it would be unfair to reduce the overall 2008 forecast for New Business.

26 Rebuttal Evidence, p. 5.
27 Ex. 114; Tr. Vol. 1, p. 4.
28 AUI Argument, p. 14, ll. 29-39.

41. With respect to unit costs for 2009, given that the Commission has accepted a capital inflation rate of 5 percent for 2009, as noted previously in this Decision, the Commission considers that this inflation rate should be applied to unit costs for 2009. Therefore the Commission directs AUI in the compliance filing to adjust the 2009 unit costs for material and labour associated with system betterment so that the Schedule shown in UCA-AUI-7(b)(ii) shows a Change in Total Cost (%) of 5 percent instead of 7 percent, 6 percent, and 7 percent, respectively, for Rural-Other, Rural Subdivision, and Town.

42. With respect to AUI's land and inspection costs, the Commission notes AUI's accuracy in forecasting these costs as they relate to capital expenditures for 2008. The Commission also recognizes that overall, there was less than a 10 percent difference in 2008 between forecast and actual costs. While UCA's argument refers only to inspection costs, in response to UCA-AUI-7(e), the Commission notes that of the 2008 forecast of $1,876,000, land constitutes 32 percent of the total with inspection costs making up the remaining 68 percent. Given the significant weighting of land in the total, the Commission considers that this supports the view that the 2008 forecast is reasonable. On this basis, the Commission accepts AUI's forecast of these costs for 2008.

43. The Commission notes that, with respect to 2009, UCA has recommended that the inspection component be set at $1,188,000 based on an inflation rate of 5 percent and the addition of one FTE at $75,000. The Commission notes that if the 2009 forecast is reduced by $75,000 to $1,428,100, an implied inflation rate of approximately 11 percent is required to inflate the 2008 forecast of $1,277,400 to $1,428,100. The Commission considers that this implied inflation rate is too high. UCA has recommended the use of a 5 percent inflation rate. Given that the Commission has previously accepted a 5 percent inflation rate for capital expenditures, the Commission considers that a 5 percent inflation rate should be used to inflate the inspection component. Applying the 5 percent inflation rate to the 2008 forecast of $1,277,400 and adding the additional FTE results in a 2009 forecast of $1,416,270, which the Commission considers to be a reasonable amount for inspection costs in 2009. Therefore, the Commission directs AUI in the compliance filing to reduce its 2009 forecast inspection costs from $1,503,100 to $1,416,270.

3.3.2 System Betterment

44. AUI submitted that the Commission should approve AUI's 2008 forecast for system betterment of $5,662,800, as reflected in the Second Forecast Update, less a downward adjustment of $530,200 to account for cancelled and deferred system betterment projects, for a forecast adjusted amount of $5,132,600. Similarly, AUI submitted that its 2009 forecast for system betterment of $6,340,200, reflected in the Second Forecast Update, plus an upward adjustment of $448,900 to account for 2008 system betterment projects deferred to 2009, resulting in a forecast adjusted amount of $6,789,100 should be approved. AUI submitted that these amounts represent the reasonable and prudent forecast expenditures for system betterment in 2008 and 2009 and approval of these amounts would be fully consistent with the fixed forward and multiple test year method of regulation.

Views of AUI and the Interveners

45. UCA recommended that several system betterment projects, which had been cancelled or deferred in 2008 and 2009, either be removed from 2008 capital expenditures or be deferred until

2009.[29] UCA noted that while AUI asserted that those cancellations and adjustments to work-in-progress identified in UCA-AUI-8(i) had been reflected in the Second Forecast Update, under cross examination Mr. Mantei agreed “we did not make those adjustments in ’08, ’09.”[30]

46. UCA noted that the $449,000 of deferred projects in 2008[31] would attract an additional $22,000 of AFUDC in 2009. UCA therefore submitted that the 2008 closing balance of plant-in-service should be reduced by $479,000 (material and labor only) and the 2009 closing balance of plant-in-service should be reduced by $8,000 as a result of the cancellations and deferrals.

47. UCA noted that, in AUC-AUI-15, a significant portion of the reduction in system betterment expenditures in 2008 was likely due to the delays with the Beaumont Gas Supply Loopline and that although AUI agreed to place this project into CWIP at year-end 2008, the delays will reduce capital expenditures in 2008. UCA considered that the AFUDC calculations should also be adjusted to fully account for the delays. However, this still leaves a large unexplained reduction in system betterment projects, some of which were deferrals and some of which were unidentified projects “not occurring” (cancelled) as noted by AUI in argument.[32] UCA submitted that no evidence was provided for the amount of 2008 projects deferred as opposed to those which were cancelled or did not occur. UCA considered that AUI’s proposed treatment effectively treated all these reductions as deferrals into 2009. UCA noted that even AUI seems to have accepted that “capital projects that do not proceed as being one of the specific instances where, under a fixed forward test year system of regulation, new actual information should supplant forecast information.” UCA submitted that the unidentified 2008 projects that were cancelled or did not occur should be removed from 2008 and 2009 property balances.

48. UCA also noted that AUI did not change its forecast amount for 2008 of $5,662,800 in the Second Update. However, AUI’s 2008 actual amounts, filed shortly thereafter on March 30, 2009, reduced the forecast amount by $1,762,883 to $3,899,917, or a 31 percent reduction. UCA considered this called in to question the veracity of the 2008 forecast.

49. UCA was also concerned with the 2009 forecast of $6,340,200 for system betterment as a result of the $1,762,883 reduction in 2008. Considering the historic amounts associated with system betterment, and the 31 percent reduction in the 2008 forecast identified in the 2008 actual results, UCA submitted that a 31 percent reduction to the 2009 forecast of system betterment expenditures to $4,375,000 would also be warranted. This would be in line with system betterment expenditures over the period 2005-2008.

50. AUI submitted that its 2008 forecast for system betterment of $5,662,800, reflected in the Second Update, less a downward adjustment of $530,200 to account for cancelled and deferred system betterment projects, for a forecast adjusted amount of $5,132,600 should be approved. Similarly, AUI submitted that its 2009 forecast for system betterment of $6,340,200, as reflected in the Second Update, plus an upward adjustment of $448,900 to account for 2008 system betterment projects deferred to 2009, for a forecast adjusted amount of $6,789,100 should be approved. AUI submitted that these adjusted forecasts represent the reasonable and prudent

[29] Ex. 63, UCA Evidence, p. 8.
[30] Tr. Vol. 1, p. 44, ll. 24-25.
[31] Ex. 114, Undertaking, Tr. Vol. 1, p. 45.
[32] UCA Reply Argument, para. 21.

forecast expenditures for system betterment in 2008 and 2009 and approval of these amounts is fully consistent with the fixed forward and multiple test year method of regulation.

51. UCA recommended that AUI's 2008 and 2009 closing balances for plant in service be reduced by $479,000 and $8,000 (material and labour only) respectively. AUI concurred provided that a corresponding increase of $479,000 to the 2009 closing balance plant in service, which was reflective of the 2008 reduction/deferral, was made.

Views of the Commission

52. With respect to the system betterment costs for 2008, the Commission notes the significant difference between the 2008 forecast and 2008 actual results for system betterment costs and the UCA's recommendation for a reduction of $479,000. The Commission agrees with UCA's recommendations in this regard. Therefore the Commission directs AUI in the compliance filing to reduce the 2008 forecast by the known cancellations and deferrals of $479,000 and to further reduce the 2008 forecast by the unidentified projects that were cancelled or did not occur, and to provide appropriate schedules in the compliance filing so the Commission and interveners can examine the adjustments.

53. The Commission notes that AUI recommended the 2009 forecast should be increased by $448,900 to $6,789,100, to account for the 2008 deferred projects. The Commission is concerned with AUI's forecast for 2009, given the significant difference between the 2008 forecast and 2008 actual results for system betterment costs. While AUI has explained that the $1,762,883 variance relates to deferred, cancelled and other unidentified expenditures not occurring, the Commission notes that according to AUI, deferred projects account for $448,900 or slightly over 25 percent of the difference.

54. The Commission notes that UCA's recommendation of $4,375,000 appears to be in line with historical amounts dating back to 2005. Further, adding the deferred project costs from 2008 to the 2008 actual amounts ($479,000 + $3,899,917) results in an amount of $4,378,917, which is very close to the amount recommended by UCA. This provides support for the UCA's recommendation.

55. While AUI has provided information with respect to the need for its forecast system betterment projects for 2009, the Commission is not convinced that AUI will be able to complete the forecast volume of work in 2009, based on historical system betterment costs. For these reasons, the Commission will reduce the 2009 forecast. Therefore the Commission directs AUI in the compliance filing to reduce its 2009 system betterment costs to $4,375,000.

56. Notwithstanding these reductions, the Commission has also issued further directions with respect to certain projects discussed below.

3.3.3 General Plant

57. AUI noted that it placed a great deal of information relating to need, alternatives and costs in various business cases before the Commission relating to its general plant projects and no evidence was filed by interveners disputing or challenging AUI's 2008 and 2009 forecasts for general plant expenditures. AUI submitted that the AUC should approve AUI's 2008 and 2009 forecasts for general plant as filed.

58. The Commission considers that parties have not made any specific recommendations with respect to General Plant. The Commission has reviewed AUI's forecasts of these amounts, and notes that the most significant driver associated with the increases in this category is the Tariff Billing Code project. Given that AUI was instructed by the Commission to undertake this project and has collaborated closely with the Commission on its execution, the Commission considers that AUI's forecasts in this category should not be reduced. On this basis the Commission approves AUI's forecast for General Plant as filed.

3.3.4 2008 Projects and Adjustments

3.3.4.1 Beaumont High Pressure Gas Supply

Views of AUI and the Interveners

59. UCA noted that this project was scheduled to start November 15, 2008 and be completed by February 28, 2009 but that AUI had included $875,900 in the 2008 capital expenditures and a further $408,400 in 2009 capital expenditures. UCA further noted that AUI agreed that the $875,900 cost of installing the pipeline should be moved to construction work in progress (CWIP) at year-end 2008 and that the 2009 costs had been included in error and that this change was reflected in the Second Update.

60. UCA submitted that, based on evidence that became available following the filing of its evidence on February 9, 2009, the amount of CWIP for this project should be adjusted to account for the delays in this project.

Views of the Commission

61. The Commission is satisfied that AUI's Second Update properly moved the costs of the Beaumont High Pressure Gas Supply project into CWIP at year-end 2008 and removed costs that were originally included in AUI's 2009 forecast. The Commission directs AUI in the compliance filing to confirm that it has updated its schedules to reflect the changes referenced above, in particular with regards to any impact that arises to rate base, depreciation expense, CWIP, and allowance for funds used during construction (AFUDC).

3.3.4.2 Highway 37 Relocation

Views of AUI and the Interveners

62. UCA noted that this project at a cost of $51,200 was cancelled by the Alberta Government but was not removed from 2008 capital additions. While AUI acknowledged that the project was cancelled, AUI submitted that "it would be inappropriate to delete the associated costs from the forecasts without considering the fact that projects that were not forecasted may have proceeded at potentially greater costs."[33] Given the changes in Tables 1 and 3 of the Second Update, which included adding the Red Earth Project and the CIS Upgrade and deferring the Head Office Expansion, UCA submitted that the Highway 37 Relocation at a cost of $51,200 should be removed from 2008 capital additions.

63. AUI agreed that its 2008 forecast for system betterment should be reduced by $51,200 to account for the cancellation of the Highway 37 Relocation project. AUI noted that the Board and the AUC identified capital projects that do not proceed as being one of the specific instances

[33] Ex 86.02, AUI Rebuttal Evidence, p. 6, ll. 15-17.

where, under a fixed forward test year system of regulation, new actual information should supplant forecast information.

Views of the Commission

64. The Commission considers that it would be reasonable to reduce the 2008 capital additions by $51,200 as recommended by UCA and agreed to by AUI, to take advantage of the new information now available. Therefore, the Commission directs AUI in the compliance filing to reduce 2008 capital additions by $51,200.

3.3.4.3 Red Earth Loopline and Relocate SE033

Views of AUI and the Interveners

65. In evidence, UCA recommended that the Red Earth Loopline, Station Upgrade Piping and Relocate SE033 should be removed from 2008 capital expenditures and plant-in-service.

66. AUI agreed that its 2008 forecast for system betterment should be reduced by $17,700 to account for the cancellation of the Red Earth Loopline project. Land inspection and the overhead portions of this project should remain in the forecast as they are fixed costs and persist despite cancellation of the project. AUI also agreed that its 2008 forecast for system betterment should be reduced by $12,400 to account for the cancellation of the Relocate SE033 project.

Views of the Commission

67. The Commission agrees with AUI that $17,700 and $12,400 should be removed from the 2008 forecast for system betterment associated with the Red Earth Loopline and Relocate SE033 projects respectively. Therefore the Commission directs AUI in its compliance filing to make these adjustments.

3.3.5 2009 Projects and Adjustments

3.3.5.1 Unidentified Border Stations

Views of AUI and the Interveners

68. UCA noted that the 2009 System Betterment expenditures include the Westlock East Town Border Station and provision for one other major unspecified project, and requested details with respect to the unspecified project.

69. AUI indicated that the total provision for unidentified stations of $400,100 in 2009 was based on the actual overall experience for 2005-2007, adjusted to reflect higher anticipated capital costs due to price increases that occurred since 2007.

70. UCA initially recommended that based on a 4.5 percent inflation rate in 2007, 4.1 percent inflation for 2008 and 5.0 percent for 2009, the 2009 overall expenditures for gate stations should be reduced by $104,000 (from $487,100 to $383,000) to reflect the proper calculation of 2009 gate station expenditures.

71. AUI noted that UCA's recommendation to reduce the 2009 forecast for Unidentified Border Stations by $104,000, which was an adjustment downward from UCA's original reduction of $121,000. AUI submitted that its 2009 forecast amount for Unidentified Border Stations should be approved as filed subject to an adjustment to account for the change in the inflation rate for construction contractor labour in 2009 (i.e., from 7.5 percent to 5 percent).

Views of the Commission

72. The Commission notes that both parties agree that construction labour inflation for 2009 should be 5 percent. Applying this inflation amount to the average actual expenditure on stations from 2005-2007 of $335,000, results in an adjusted cost of $382,649, which compares to the adjusted cost of $392,000 identified in AUI's rebuttal evidence.

73. The Commission notes that AUI used the adjusted cost of $392,000 to indicate that its 2009 forecast for unidentified border stations of $400,200 was reasonable. The Commission does not agree with the manner in which AUI used the adjusted cost.

74. The Commission notes that in response to UCA-AUI-8(g) AUI provided the details with respect to actual station additions for 2005 to 2007, in which the Commission has calculated an average of $332,366. This amount corresponds to AUI's actual average amount of $335,000. Given that the Commission's calculation is based on actual amounts, it would include both known stations and what would have been unknown stations for the years in question. Thus using the actual average amount for 2005-2007 of $335,000 and grossing it up by inflation demonstrates that AUI's 2009 forecast for border stations both known and unknown of $487,000 is high.

75. The Commission agrees with UCA that the border station forecast of $487,000 should be reduced by $104,000 to $383,000. Therefore the Commission directs AUI in the compliance filing to reduce the 2009 forecast for border stations to $383,000.

3.3.5.2 Red Earth Gas Supply and Pipeline Replacement

Views of AUI and the Interveners

76. In its First Update, AUI added the Red Earth Gas Supply and Pipeline Replacement with total expenditures for 2008 and 2009 forecast at $448,000 and $1,540,500 respectively. The project was introduced to address failures in the current pipeline.

77. AUI submitted that it obtained an alternate source of supply by constructing a 460 meter tie-in to the North Peace Pipeline (also referred to as the Midnight Oil Pipeline) at a cost of $448,800 in the fall of 2008. AUI was also attempting to purchase this pipeline or to secure a long- term supply contract with the producers on this line, and if successful would abandon the replacement project. The estimated cost of the 20 km replacement project was $1,540,000.

78. Noting that AUI, was pursuing other alternatives for gas supply to Red Earth, UCA submitted that a deferral account should be created to capture any differences in the final cost of the project and that the potential for recoveries from TransCanada who provided "off-spec" gas. UCA also noted that due to the uncertainty regarding the alternatives for gas supply the prudence of AUI's approach could only be tested at the next GRA.

79. AUI indicated that the options it was pursuing were either the purchase of another existing pipeline or a long-term transportation agreement. However, AUI indicated that it intended to move forward with the pipeline replacement as negotiations were not progressing. AUI submitted that it would be inappropriate to establish a deferral account as the criteria to establish one are in this instance not met. Further, the cost of replacing the pipeline could be accurately forecasted and controlled, thus any variance in forecast costs would likely be immaterial.

Views of the Commission

80. The Commission notes AUI's argument that the 2009 forecast for the Red Earth Gas Supply and Pipeline replacement is prudent since it will maintain operational safety and service to utility customers. The Commission considers operational safety and service to be a key criterion in considering whether or not to approve a project. Given the evidence of AUI with respect to the alternatives investigated for gas supply, and the steps being taken to resolve the issue with "off-spec" gas, the Commission is satisfied that this project is reasonable. Therefore the Commission approves AUI's 2009 forecast for the Red Earth Gas Supply and Pipeline replacement project.

81. The Commission agrees with UCA that the ultimate testing of prudence can be fully examined at a future GRA once a complete record can be established regarding the alternatives.

3.4 Capitalization Guideline/Practices

82. In Decision 2007-094, the Board directed AUI to file a more detailed capitalization policy that addressed certain issues. Additionally, the Board encouraged AUI to comply with the Canadian Institute of Charter Accountants Handbook in preparing its capitalization policy. In the Application, AUI submitted three documents forming part of AUI's Financial Control Management Practices (FCMP) that relate to the treatment of capital expenditures: FCMP #005 Contributions in Aid of Construction & Other Proceeds; FCMP #006 Authorization for Expenditure; and FCMP #007 Capitalization. AUI submitted that these combined practices result in a transparent capitalization guideline or practice that meets the EUB's directive in EUB Decision 2007-094.

Views of AUI and the Interveners

83. CG noted that AUI's capitalization policy stated that "although the meter and regulator themselves are capitalized at the time of purchase, the cost of labour on a meter exchange or replacement is expensed."[34] CG submitted the cost of meters being exchanged or replaced should take into account all direct costs, including labour. The initial capitalization of labour, when the meter is first installed, should be depreciated along with other direct and indirect costs. As both the meter material and labour costs have lives in excess of one year, CG submitted it does not make any sense to treat the labour costs on meter exchange or replacement as an expense, yet capitalize the meter material. Hence, if this meter is later exchanged or replaced, or moved to another location, the original cost associated with the initial labour costs should be retired and all new labour costs associated with the meter being exchanged or replaced should be capitalized and depreciated over the meter's remaining life. Any difference between the actual and theoretical deprecation reserve would be trued up and accounted for in the next depreciation study. Accordingly, the AUC should direct AUI to revise its capitalization policy and include, in its re-filing, capitalization of labour associated with meters being exchanged or replaced. As well, AUI should be directed to reflect all labour costs associated with meter exchange and replacement to be capitalized for the Test Years 2008-2009 in its re-filing. UCA supported CG's recommendation.

84. AUI noted that CG stated that AUI agreed that the cost of an installed meter at a site should include all costs to get that meter into a productive mode and cite an excerpt from the

[34] Ex. 2, Tab 13.

transcript of the proceeding.[35] AUI submitted that this is a mischaracterization of AUI's evidence.

Views of the Commission

85. The Commission notes that the transcript citation that CG relied on is premised on a general question put to AUI's witness, Mr. Mantei, related to putting an "asset" into service.[36] However, when Mr. Mantei was asked specifically about capitalizing labour associated with meter exchanges or replacements, Mr. Mantei first confirmed that AUI was compliant with Alberta Regulation 546/63[37] that addresses the uniform system of accounts for natural gas utilities under the *Gas Utilities Act*. He then stated that the labour component does not add value to that particular service (meaning service connection) nor does it extend the life of the meter. The Commission notes the following:

> Question. Mr. Wachowich: Now, we appreciate that the company's position is it is complaint with the 1963 PUB order, but I want to talk about whether there is a disconnect, and it seems to us that when you originally install this meter and you capitalize labour and you get that expected life from the meter and then if you come out and replace it, or I think you earlier describe it as move it, but a new meter is put in, and you have expensed the lab our in that year, one would expect that the meter is now going to have, if all other things are equal, another 20-year life, the second meter on that site. Why is that not capitalized? Why is it expensed in the year the work is done?
>
> Answer. MR. MANTEI: The meter is capitalized. The meter is capitalized immediately. The fact that you have replaced a meter at a particular service doesn't effectively add anything to the value of that particular service. You haven't done anything as far as the meter is concerned to extend the life of the meter. I'm failing to see your logic here, Mr. Wachowich. Using your logic then, we would have to – if I was to accept your treatment, we would then have to retire the cost of the labour associated with the original installation such that we could capitalize the cost of the labour for the second meter that would go onto that site.[38]

86. AUI asserted that the Uniform System of Accounts Regulation clearly states that plant account 474 is to include only the labour associated with the "original" meter installation:

> This account shall include the cost of house regulators whether actually install or held in reserve. It shall further include the cost of labour and materials used, and expenses incurred in connection with the original installation of house regulators and meters.

87. While the Uniform System of Accounts Regulation clearly states that operating account 673 is to include the labour associated with removing, resetting and changing meters:

> This account shall include the cost of labour, supplies and expenses incurred in connection with removing, resetting, changing, testing and serving customer meters and house regulators.

[35] CG Argument, p. 5.
[36] *Ibid*.; Tr. Vol. 1, p. 205.
[37] A.R. 546/63, Public Utilities Board Order No. 26402.
[38] Tr. Vol. 2, pp. 206-207.

88. Further, the Uniform System of Accounts Regulation clearly states that the meters account 878

> …shall include the cost of labour, supplies and expenses incurred in the maintenance of meters for the distribution system.

89. The Commission is satisfied that AUI's capitalization policy meets the direction from Decision 2007-094. The Commission agrees that AUI's method of expensing labour associated with meter exchanges and replacements appears consistent with the Uniform System of Accounts Regulation.

3.5 Inter-affiliate Charges - Capitalization of Costs

90. The amount of Inter-affiliate Shared Costs that AUI proposed to be capitalized are summarized in the Table below:

Table 4. Inter-affiliate Capitalized Costs

	2007 Allowed	2008 Forecast	2009 Forecast
Inter-affiliate Shared Costs	$1,151,000	$2,296,300	$2,803,400
Capitalized Costs	$403,000	$803,700	$981,200

Source: Ex. 49, ASBG/PGA.AUI-1(b) & (c).

Views of AUI and the Interveners

91. Consistent with past practice, AUI proposed to capitalize 35 percent of its Administrative and General costs (A&G) for the test years. However, with the disproportionate increase in Inter-affiliate Shared Service charges, which are now part of A&G costs, CG submitted that it was concerned whether this significant increase in the amount capitalized was appropriate and supported for the test period.

92. From Table 4 above, CG noted that it was evident there was approximately a 100 percent increase in the capitalization amount for 2008 relative to 2007 (i.e., $803,700 vs. $403,000) and a 144 percent increase in the capitalization amount for 2009 relative to 2007. Under cross-examination, AUI was asked whether this large increase in the capitalization amount caused AUI to review the capitalization ratio.[39] AUI acknowledged the large increase but stated the capitalization ratio has existed for some time and no review was initiated when such large increases became apparent for the test years. AUI further stated the incremental increase from 2007 to 2008, of $401,000, did not represent incremental costs to support the construction program. Rather, it represented what was characterized as a full allocation of A&G costs and any costs not capitalized would be expensed.[40]

93. CG noted AUI's forecast capital programs were not increasing by 100 percent and 144 percent relative to 2007. Therefore, AUI should not require this level of incremental overhead expenditures. CG considered that AUI had not substantiated the more than doubling of inter-affiliate shared costs as overhead for construction projects and recommended that the capitalized amount for each of the test years be capped at the 2007 allowed level of $403,000, appropriately

[39] Tr. Vol. 1, p. 99.
[40] Tr. Vol. 1, p. 100.

escalated for inflation. This cap would ensure that unnecessary and unsupported AUGI overhead costs were not arbitrarily assigned to construction projects or receive rate base treatment.

Views of the Commission

94. The Commission notes that AUI's 35 percent capitalization factor for A&G costs was most recently approved in Decision 2007-094. Although the Commission is mindful of the significant increases in forecast inter-affiliate costs, the Commission is not persuaded that a cap should be applied to AUI's capitalization of inter-affiliate costs. There is no evidence that an increase in inter-affiliate costs would result in a change in the proportion of costs to be capitalized. In addition, given the recent review of AUI's capitalization factor the Commission questions the value that would be obtained by conducting a review at this time. On this basis, the Commission accepts AUI's capitalization factor of 35 percent.

3.6 Business Case Threshold

95. In Decision 2005-127,[41] with respect to AUI's 2005-2006 GRA, the EUB directed AUI to file detailed business cases at its next GRA for all planned capital expenditures in excess of $50,000. AUI met this directive in both its 2007 GRA and in the Application. AUI sought Commission approval to increase the threshold for filing business cases in future proceedings from the current $50,000 to $100,000 as the value of preparing such detailed business cases was not commensurate with the effort entailed.

Views of AUI and the Interveners

96. AUI submitted that, if the Commission approves the change in threshold for the preparation of business cases, it would still provide justification for future GRAs for capital expenditures forecast to be less than $100,000 but to the level of detail it provides in its business cases.

97. While UCA was prepared to increase the threshold for business cases to $100,000, it submitted that AUI should at minimum provide a listing of individual projects that exceed $50,000 and update these projects in the normal course of filing updates.

98. AUI submitted that, if the Commission approved the change in threshold for the preparation of business cases, it would still provide justification in future GRAs for capital expenditures forecast to be less than $100,000 but not to the level of detail it provides in its business cases. As demonstrated for the 2008 and 2009 forecast years, applying the requested $100,000 threshold for preparation of a business case would have impacted very few of AUI's forecast capital expenditures while eliminating a significant amount of work and effort for AUI.

Views of the Commission

99. The Commission recognizes that considerable work is required to file business cases within a GRA and that a threshold requirement of $50,000 may offer little added value against the effort and cost required to prepare a business case. The Commission considers that setting the threshold at $100,000 is reasonable given that AUI has indicated that it will provide justification for capital expenditures less than $100,000. The Commission therefore approves AUI's request to increase the threshold for filing business cases in future proceedings from the

[41] Decision 2005-127: AltaGas Utilities Inc., 2005/2006 General Rate Application – Phase I (Application No. 1378000) (Released: November 29, 2005).

current $50,000 threshold to $100,000 on the condition that AUI provide a listing of individual projects that exceed $50,000 and update these projects in the normal course of filing updates.

3.7 Purchasing Burden

100. AUI added $299,882 and $253,336 to capital assets in respect of its 10 percent purchasing burden for 2008 and 2009, respectively.

Views of AUI and the Interveners

101. CG noted that in Decision 2007-094, AUI was directed to file an assessment of its purchasing burden in the next GRA. CG considered that the purchasing burden seemed reasonable, except as it related to office equipment and recommended that AUI should remove all purchasing overhead allocated to office furniture in its 2008-2009 compliance filing application, and make the necessary changes to its accounting policies.

102. Noting AUI's statement that the purchasing burden was a "credit against general overheads," CG stated there was a lack of transparency as to where the offset to these costs was recorded. CG expected that this offset would be shown as a credit to operating expenses, and considered that AUI's explanation of this issue was not useful. CG recommended that AUI provide evidence in its refiling application to demonstrate the costs of the Purchasing Group within the Corporate Services department and Operating Services department were appropriately credited and only the net costs of these departments were shown in the 2008-2009 revenue requirements.

103. AUI noted that it forecast approximately $26,809, representing approximately 0.1 percent of its 2008 forecast capital expenditures, and $10,436, representing approximately 0.04 percent of its 2009 forecast capital expenditures, as purchasing burden relating to furniture. AUI considered that the purchasing burden was the equivalent of "stores expenses" under the Uniform System of Accounts Regulation, further, any reduction in purchasing burden associated with office furniture would shift that amount from general plant to other plant. As a result, if the Commission were to adopt CG's recommendation to remove office furniture from AUI's purchasing burden, there would be no net effect to AUI's total plant.

104. CG also took issue with the "transparency" of AUI's allocation of purchasing burden and the associated credit against total overheads being included in AUI's forecast revenue requirement. AUI indicated that it would address CG's concern in its re-filing to add a reconciliation of overhead distribution and total overheads with purchasing burden being credited against total overheads.

Views of the Commission

105. The Commission notes that CG generally considered that AUI's approach with respect to its purchasing burden was reasonable. The Commission agrees with this position.

106. While CG considered that purchasing burden amounts associated with office equipment should be removed from AUI's forecast and accounting policies changed accordingly, the Commission notes the negligible amount associated with furniture in AUI's forecast capital expenditures. Further AUI indicated that these amounts would shift from general plant to other plant resulting in no change to AUI's total plant. On this basis the Commission considers that little would be gained by implementing CG's recommendation. Therefore, the Commission will not issue any directions in this regard.

107. The Commission notes that AUI has indicated that it will address CG's concern with respect to transparency of the purchasing burden. The Commission finds this proposal to be helpful, and directs AUI in the compliance filing to include this reconciliation. Further, the Commission directs AUI in the compliance filing to outline any offsets that are applicable to operation expenses.

3.8 Allocation of Overheads

108. AUI forecasted $2.638 million in 2008 and $3.103 million in 2009 with respect to these indirect costs and allocates them based on a ratio of a project's direct cost to the total of all project direct costs.

Views of AUI and the Interveners

109. CG noted that AUI's Capitalization Policy provides for a number of indirect costs, "incurred to support or facilitate the installation of facilities required to deliver natural gas to a customer" to be capitalized. CG submitted that AUI's evidence on this point was contradictory, as AUI's testimony suggested that general overhead was applied to <u>all</u> transmission and distribution (T&D) assets; however, in response to CG.AUI-14(c), AUI indicated that T&D assets are <u>not</u> charged any overhead expenses. CG recommended that AUI expand the allocation of the general overhead costs to include Transmission Plant and Distribution Plant, Land, Land Rights and Distribution Plant in its re-filing.

110. In response, AUI submitted that its forecast capital expenditures fall within four categories: new business, system betterment, general plant and cost of removal. These categories along with the subcategories were functional delineations. Within these delineations costs were segregated by fixed asset account number i.e. all transmission plant, distribution plant and general plant accounts. AUI noted that its response to CCA-AUI-14(c), was formatted incorrectly. The second and forth bullets were meant to be sub bullets with the result that "land and land rights" being a subset of the "transmission and distribution plant" and each of "meters" and "regulators" subsets of the "distribution." As a result, AUI allocates a portion of its overheads to each of transmission plant and distribution plant.

Views of the Commission

111. The Commission has reviewed AUI's submission on this matter and its correction to information response CCA-AUI-14(c). Based on this information, the Commission finds that AUI is allocating its overhead appropriately. On this basis, the Commission considers that no further directions are required with respect to the allocation of overheads.

3.9 Working Capital

112. AUI conducted a lead lag study, which resulted in its proposal that the revenue lag associated with working capital be changed from 37.30 days to 39.48 days. In addition AUI's working capital for 2008 and 2009 was forecast at $1,476,467 and $1,945,770, respectively.

Views of the Commission

113. The Commission considers that AUI has properly included a detailed lead lag study to support its necessary working capital (NWC) and requested change in its revenue lag, and sees no reason to deny AUI's requested revision to its revenue lag. The Commission also notes that interveners filed no objections or concerns with regards to AUI's NWC and AUI's proposed

change on revenue lag days from 37.30 days to 39.48 days. AUI's NWC methodology, change in revenue lag, and NWC are approved as filed in AUI's Second Update, subject to any changes as per this decision.

4 OPERATING, MAINTENANCE AND ADMINISTRATIVE EXPENSES

114. In the First Update and Second Update AUI adjusted certain operating, maintenance, and administrative (OM&A) expenses. The results of those adjustments are set out in the following Table:

Table 5. Operating, Maintenance and Administrative Expenses

	2007 Allowed	2007 Actual	2008 Forecast	2009 Forecast	2008 Forecast	2009 Forecast	2008 Forecast	2009 Forecast
			July 14, 2008		First Update		Second Update	
	$000	$000	$000	$000	$000	$000	$000	$000
Salary Expense	9,454	9,418	10,677	12,666	10,627	12,683	10,627	12,588
Staff Benefit Expense	2,310	2,049	2,479	2,571	2,445	2,594	2,445	2,933
Bad Debts	79	75	73	81	73	81	73	84
Insurance *	474	473	537	622	484	492	484	492
Legal Fees *	83	79	91	120	91	100	91	100
Consultant and Other Fees	312	382	784	927	646	927	646	927
Regulatory Fees	1,009	1,009	1,020	1,050	1,018	1,048	1,018	1,048
Amortization of CEO/CFO Certification Costs	488	489	340	340	340	340	340	314
Other Unadjusted Amounts	7,256	7,801	9,566	10,394	9,566	10,394	9,566	10,394
Capitalization	(986)	(1,005)	(1,503)	(1,737)	(1,484)	(1,685)	(1,484)	(1,685)
Total OM&A Expenses	20,479	20,770	24,064	27,034	23,806	26,974	23,806	27,195

* Subject to capitalization

Source: Refer to Ex. 2, Table 36, and Ex. 78, Table 8.

4.1 Inflation Forecast

115. For OM&A expenses, capital costs and other costs, AUI used general cost inflation factors (general factors) of 3.5 percent for 2008 and 2.9 percent for 2009. The general factors, which were determined using Alberta CPI forecasts issued between April and October, 2007, were used for the majority of operating expense line items appearing in Schedule 2.5 of the Application. In addition to general factors, AUI indicated that it used specific cost change information where available and provided a table that identified where specific factors were used with respect to its inflation forecast.[42]

[42] Ex. 16.01, AUC-AUI-1.

116. AUI forecast salary increases of 5.3 percent and 5.0 percent respectively in 2008 and 2009 for its bargaining unit employees. AUI indicated that a Collective Bargaining Agreement with its bargaining unit employees underpinned the increases and was in effect until December 31, 2009. For its non-bargaining unit employees AUI proposed a 5.0 percent salary increase for the test period.[43]

117. AUI proposed composite contractor escalation rates of 4.1 percent in 2008 and 7.5 percent in 2009. The rates were comprised of a labour and a material component. For the labour component AUI proposed an escalation rate of 4.1 percent for 2008 and 10.6 percent for 2009. AUI submitted that current agreements with contractors expired in 2008 and that a new contract would be entered into in March, 2009; AUI expected that costs arising out of the new contract for 2009 would not vary significantly from its 10.6 percent forecast.[44] AUI's proposed escalation factors for the material component, of 3.5 percent for 2008 and 2.9 percent for 2009, were based on AUI's general cost inflation (General) factors.[45]

Views of AUI and the Interveners

118. Referring to a BMO Capital Markets update, which indicated that the CPI would increase approximately 1.2 percent in 2009, CG recommended that:

a. more recent information should be used to determine the general escalation rates applicable to the majority of operating expenses;
b. the non-bargaining unit salary increase for 2009 be reduced by 1.7 percent to 3.3 percent; and
c. the composite rate for contractor labour escalation be established with the range of 2.1 percent and 3.3 percent.[46]

119. AUI stated that it had already reduced its forecast management salary increase downward from 6.02 percent to 5.0 percent to reflect changes in the economic climate. Moreover, the 5.0 percent increase was consistent with specific salary and wage industry specific data at the time of the forecasts versus the "recent" general CPI data relied on by CG. For the above reasons, AUI submitted that CG's recommendation to reduce AUI's 2009 forecast increase for non-bargaining unit employees should be rejected.

Views of the Commission

120. The Commission notes that AUI estimated the 2009 CPI-indexed increase for contractors to be 2.1 percent and that only one of AUI's contractors had indicated that it would accept the increase.[47] The Commission observes that AUI's expectations in regard to its proposed composite contractor rates for 2009 "have come down considerably [and AUI's] … best number, is somewhere between 2 and a half per cent and 7 and a half per cent."[48]

121. With respect to AUI's proposed 2009 contractor labour rate, the Commission is reluctant to move to the range suggested by CG considering that CG's recommendation was based on a market update dated March 20, 2009, and may not be representative for the entire year. The

[43] AUI Argument, p. 25.
[44] Ex. 16.01, AUC-AUI-11.
[45] Ex. 16.01, AUC-AUI-1.
[46] CG Argument, pp. 11-14.
[47] Ex. 49.01, ASBG/PGA-AUI-2.
[48] Tr. Vol. 2, p. 268.

Commission finds a 5 percent composite escalation rate for contractors, the mid-point of AUI's estimate, to be reasonable. Further, the Commission has previously approved a 5 percent inflation rate for capital inflation, which adds further support to the Commission's view that 5 percent is reasonable. Therefore, on this basis the Commission directs AUI, in its compliance filing, to use a 5 percent direct contractor escalation rate in its 2009 revenue requirement.

122. Regarding AUI's forecast for non-bargaining unit employees' for the 2008-2009 test period, the Commission notes that interveners did not express concerns related to AUI's proposed 5.0 percent inflation rate for 2008 wherein AUI used a 1.5 percent escalation rate to determine its non-bargaining unit inflation rate. The Commission finds AUI's proposed non-bargaining unit inflation rate and escalation rate for 2008 to be reasonable.

123. With respect to AUI's forecast non-bargaining unit employees' 2009 inflation rate the Commission is aware that AUI could not have forecast the current realities of the Alberta economic environment at the time it filed the Application. Further, the Commission acknowledges that AUI did adjust its original forecast increases for non-bargaining unit employees from 6.02 percent to 5.0 percent in its Second Update.[49]

124. However, it is precisely due to the fluctuating nature of inflation and interest rates that the Commission prefers to use the most up to date information possible when assessing such forecasts. In this case, in coming up with its forecast non-bargaining unit employees' inflation rate for 2009, AUI used an average of three CPI data points from 2007 as a starting point. In contrast, CG provided evidence of one CPI figure from 2009 as a comparator.

125. While the Commission would prefer to assess AUI's 2007-sourced CPI data against more up to date information, without evidence that the single CPI figure supplied by CG is more indicative of a general trend in 2009 (i.e. prepared as an average with other 2009 CPI figures), the Commission is concerned that this single data point may not be a reasonable value against which to assess AUI's forecast.

126. In addition, the Commission notes that AUI's updated forecast inflation rate of 5.0 percent for non-bargaining unit employees is the same as AUI's forecast for 2009 for its collective bargaining unit employees. In this regard, the Commission recognizes that non-bargaining unit employee compensation may be influenced by the settlements reached with bargaining unit employees.

127. For these reasons, the Commission approves AUI's updated forecast of 5.0 percent for 2009 non-bargaining unit inflation rate.

4.2 Labour Vacancies

128. AUI forecast to add 15 permanent positions in 2008 and 15 permanent positions in 2009. AUI indicated that staff additions were driven by one or more of the following:

- Customer growth;
- Public & Worker Safety and Environment;
- Regulatory and Legal; and
- Business Process Efficiency and Quality.

[49] AUI Argument, p. 25.

129. In addition to identifying the positions that were forecast to be added, AUI identified the factors that were the primary drivers underpinning the need for the positions and provided specific justification(s) for each of the forecast staff additions.[50]

4.2.1 Date of New Hires

130. In the Application, AUI indicated that although justifications for its forecast staff additions indicated a variety of start dates in each of the test years, the 2008 positions were all forecast to be filled by September 1, 2008 while the 2009 positions were forecast to be filled by April 1, 2009.[51] In its First Update, AUI indicated that "[a]s a result of the addition of the customer information systems (CIS) upgrade … the Company has added four positions in October of 2008."[52]

131. When requested to "provide the actual full time equivalent (FTE) additions for 2008" AUI submitted that 17 of the 19 forecast FTE additions had been filled and the actual average start for new hires in 2008 was September 2, 2008.[53] However, with respect to its 2009 forecast for new hires, AUI submitted that only 2 of the 15 positions had been hired as of April 1, 2009.[54]

Views of AUI and the Interveners

132. Noting that the majority of the 2008 forecast FTEs had been hired and the forecast risk associated with AUI's proposed staff additions was all but removed CG and UCA submitted that AUI's forecast in-service date for new hires in 2008 appeared reasonable.

133. Noting that only two of the forecast fifteen positions for 2009 had been hired, CG recommended that all new hires in 2009 be assumed to commence service at mid-year (July 1). CG offered the following rationale:

- Given the dynamic nature of business requirements, it was not reasonable to forecast with any degree of precision the exact date when a new hire would commence service;
- The results of actual experience over the period 2005-2007 indicate that new hires, on average, commence at mid-year; and
- The Commission (and its predecessor the Board) approved the mid-year concept for new hires for other regulated utilities.

Considering the above, UCA and CG agreed that AUI should include, in its compliance filing, a mid-year hiring assumption with an accompanying reduction of $242,000 with respect to 2009 forecast total salary cost. UCA added that benefits should be reduced by $53,000.[55]

134. AUI agreed that while not all of its forecast 2009 positions were filled by its forecast April 1, 2009 start date, most of the positions were in either the interview or advertisement stage by that date. As such, AUI suggested that its start date was more accurate than the proposed July 1 date proposed by interveners and submitted that AUI's forecast April 1, 2009 start date for new hires should be approved.

50 Ex. 2, Application, pp. 116-120.
51 Ex. 2, p. 120.
52 Ex. 14.01, p. 66.
53 Ex. 114.01, Response to Undertaking, Tr. Vol. 1, p. 182, l. 9.
54 Tr. Vol. 1, p. 111.
55 Ex. 63.02, p. 12; CG Argument, pp. 21-23.

Views of the Commission

135. The Commission notes that the actual 2008 average hiring date for new hires was September 2008 and also notes that this date was close to the average mid-July start date for new hires over the period 2005 through 2007. Noting that only two of the proposed fifteen positions had been filled by AUI on April 1, 2009, the Commission finds the proposed start date of July 1, 2009 to be more reasonable than AUI's April 1, 2009 start date. Therefore, the Commission directs AUI, in its compliance filing, to use the July 1 start date for its forecast of new hires.

4.2.2 Frictional Vacancy Rates

136. In its forecast AUI identified that a vacancy rate in existing positions (frictional vacancies) of approximately five FTEs could be sustained in the short-term for each year of the test period.

Views of AUI and the Interveners

137. UCA submitted that the actual frictional vacancy for the period from 2005 to 2007 was 3.7 percent. Using this value as a proxy for the test years, UCA stated that forecast frictional vacancies for 2008 and 2009 should be 6.8 and 7.4 FTEs, respectively; 1.7 FTEs greater for 2008 and 2.8 FTEs greater in 2009 than what AUI forecasted. Accordingly, UCA recommended that salaries and benefits should be reduced by $162,000 in 2008 and $290,000 in 2009.[56]

138. AUI stated that if the vacancy rate were to increase AUI would incur added costs in the form of overtime and contractor costs:

> … Mr. Bruggeman identifies a reduction in salaries due to the level of frictional vacancies. In its forecast AUI identified a level of vacancy that can be sustained in the short term. This level, approximately 5 FTE, is made up of customer service technicians and support staff. **If the level of vacancy increased much beyond this level, AUI would require that staff work overtime or that contract staff be engaged to complete the deferred work**.[57] [emphasis added]

AUI submitted that UCA's recommendation should be rejected.

Views of the Commission

139. The Commission notes that AUI did not address UCA's argument that a 3.7 percent average frictional vacancy rate occurred during the period 2005 through 2007.

140. The Commission finds the use of historical average frictional vacancy rates as a reasonable predictor of FTE vacancy rates for the test period. Therefore, the Commission directs AUI, in its compliance filing, to incorporate a 3.7 percent frictional rate in its revenue requirement, resulting in a frictional vacancy rate of 6.8 and 7.4 FTEs in 2008 and 2009 respectively.

[56] Ex. 63.02, p. 12.
[57] AUI Reply Argument, p. 11.

4.2.3 Productivity

Views of AUI and the Interveners

141. When asked to explain why customer to FTE ratios had decreased from 2005 to 2009 AUI stated:

> AUI's business has changed in recent years, primarily due to increased regulatory requirements
>
> …
>
> AUI's staffing levels grew only 5% between 1994 and 2004, whereas its customer base grew by 26% during the same period … [Accordingly,] need to "catch up" has led to some of the staffing increases.[58]

142. UCA asserted that AUI had failed to quantify economies of scale or capital expenditures that were designed to reduce manpower and increase efficiency. Further, the evidence provided in UCA-AUI-15(a) demonstrated declining productivity and indicated that AUI had consistently over-forecast year-end FTEs and Customer Service Technicians (CSTs). UCA submitted that a conservative reduction to the overall forecast of additions was 6 FTEs in each of the test years.[59] Further, salaries and benefits for 2008 and 2009 should be reduced by $573,000 and $1,244,000 respectively to reflect the recommended reduced number of staff additions.[60]

143. AUI stated that UCA's productivity evidence failed to account for other factors:

> … historical understaffing, explosive growth of customer connections out-pacing new permanent positions, the need for core resources in operating areas not otherwise related directly to customer growth, and the proportion of fixed costs and variable costs associated with operating a utility regardless of its size.[61]

AUI submitted that the ratios put forth by UCA as a means of measuring productivity are not in any way an accurate measurement of AUI's productivity nor are they in any way representative of what the necessary and appropriate number of permanent positions is for AUI.[62]

144. UCA replied that while AUI had provided a generic description of the factors that supported the additional positions, AUI had not addressed UCA's submission wherein AUI had over-forecast year-end FTEs in the period 2005 through 2007 by an average of 5.7 FTEs. Moreover, the persistent over-forecasting demonstrated that AUI's actual productivity was significantly greater than what was forecast.[63]

145. AUI submitted that it intended to fill every position. The justifications for these positions were based on need and not productivity, and history did not support UCA's conclusions that AUI had consistently over-forecasted its year-end FTEs:

58 Ex. 47.01, UCA-AUI-15.
59 UCA Argument, p. 12.
60 Ex. 63.
61 AUI Argument, p. 26.
62 Ibid.
63 UCA Reply Argument, p. 13.

> In 2007 AUI forecast 11 new positions and actually added 14 during the calendar year. In 2008 AUI originally forecast 15 new positions for 2008 and then updated this to 19, subsequently filling 15 of them in 2008, two more in early 2009 and deferring the remaining two positions to later in 2009.[64] [footnotes omitted]

146. The necessity component for establishing new positions and filling them in order to provide utility service to customers was absent from UCA productivity analysis. Additionally, UCA submitted that using year-end FTEs as a measure of overall head count was misleading as t a year-end vacancy does not account for a position that may have been filled during the year. For the above reasons, AUI submitted that UCA's suggestion should be rejected.

Views of the Commission

147. The Commission agrees that using year-end FTEs as a measure of overall head count can be misleading as a year-end vacancy does not account for a position that may have been filled during the year. Moreover, the Commission notes the following:

- AUI's assertion that the ratios put forth by UCA as a means of measuring productivity do not address what the necessary and appropriate number of permanent positions is for AUI as AUI's business has changed in recent years,[65] and
- AUI's submission wherein "AUI's staffing level grew only 5 percent between 1994 and 2004, whereas its customer base grew by 26 percent during the same period … AUI has been addressing a need to restore its front-line staffing to levels that can adequately meet the demands of new and existing customers for safe, dependable service."[66]

Further, the Commission recognizes that AUI filled 14 new positions in 2007 compared to the 11 that were originally forecast. In 2008 AUI filled 15 of nineteen positions, although 15 positions were originally forecast. Therefore the Commission considers that these additions confirm AUI's position that staffing increases are the result of the need to catch up with customer growth.

148. Considering the above, the Commission finds that UCA has not offered compelling evidence that would cause the Commission to reduce AUI's proposed FTE increases in the test years. Therefore the Commission rejects UCA's submission that salaries and benefits for 2008 and 2009 be reduced by $573,000 and $1,244,000 respectively.

4.2.4 Reduction in Staff Levels due to New Compressed Natural Gas Units

149. Due to the obsolescence of the only compressed natural gas (CNG) unit that it had, AUI submitted that it no longer possessed the capability to respond to a loss of gas supply situation with portable natural gas units. The purchase of four 20 Mcf portable CNG units, starting with two in 2008 and two in 2009, at a cost of $200,000 in each year, would enhance AUI's abilities to respond to loss of gas supply. Further, AUI's customers would benefit immediately as the units could be incorporated into scheduled maintenance work, pipe replacement programs and emergencies. The business case for the CNG units indicated a net present value savings of $413,365 over the life of the units primarily attributable to the elimination of $50,000 per year due to the elimination of customer relighting. AUI incorporated the following assumptions into its present value analysis:

[64] AUI Reply Argument, p. 11.
[65] Ex. 47.01, UCA-AUI-15.
[66] Ex. 47.01, UCA-AUI-15.

a) AUI will, on average, experience 2 emergency situations annually that would require the rental of a CNG unit from another utility at a cost of $7,000 per day. Each emergency would result in 3 days of rental, at a cost of $21,000 per emergency, or $42,000 for the year;
b) AUI will experience 20 situations in which gas supply to a group of customers would have to be interrupted to facilitate construction or maintenance work. In the absence of a means to keep the customers active, each situation would require the re-lighting of 50 customers, on average, at a cost of $2,500 per situation. For 20 such situations, the annual cost would be $50,000;
c) the annual avoided operating expense available to AUI through the purchase of the CNG units is $92,000 per year.
d) the annual operating costs of the CNG units will be $7,500, calculated as follows:

  - $1,000, for inspection
  - $1,000 for insurance
  - $500 labour per C&M deployment
  - $5,000 labour per emergency deployment

e) the net operating cost associated with the CNG trailers is a reduction of $84,500.[67]

Views of AUI and the Interveners

150. In addition to the overtime savings identified in the business case, AUI submitted that the availability of the units would reduce the need to design supply contingencies into projects such as the use of full system bypass equipment and restricting certain activities to warm weather conditions. AUI proffered that the CNG units would provide more flexibility in terms of scheduling and completing work.[68] Moreover, AUI submitted that it was not possible to reduce staff by 1.0 FTE when the total benefit was realized across the entire operation.[69]

151. UCA submitted that if AUI experienced the 20 gas supply interruptions that it assumed in the economic analysis, then its need for operating staff would be reduced. CG recommended that AUI’s staff levels be reduced by 0.5 FTE in 2008 and 1.0 FTE in 2009 to correspond to the reduction in re-lighting activities that arise out of AUI acquiring two new portable CNG units in each of 2008 and 2009.[70]

Views of the Commission

152. The Commission agrees with AUI that a reduction of .5 FTE and 1 FTE is impractical due to the fact that the total benefit of the CNG Units is realized across the entire operation. Further, the Commission is willing to accept AUI’s explanation that the CNG units may also produce overtime savings and offer greater operational flexibility for AUI, while enhancing security of gas supply for customers. UCA’s recommendation is therefore not accepted and AUI’s forecasts are approved as filed.

[67] Ex. 1, GP109 – Portable CNG units.
[68] UCA-AUI-8, Ex. 47.01.
[69] Ex. 86, p. 10.
[70] Ex. 63, p. 11.

4.3 Short Term Incentive Plan

153. AUI forecasts of short term incentive plan (STIP) for 2008 and 2009 were $872,100 and $1,060,500 respectively; 2007 STIP actual payments totaled $724,000. AUI provided the following details in support of these amounts:[71]

Table 6. STIP

	2007 Allowed	2007 Actual	2008 Forecast	2009 Forecast
		($000)		
Bargaining Unit	242.2	225.6	305.5	347.8
Salaried Staff	372.5	351.0	400.4	521.6
Executive	171.5	165.0	213.1	244.6
Executive disallowed	(62.2)	(30.3)	(46.9)	(53.5)
	724.0	711.3	872.1	1,060.5

154. The Board in Decision 2007-094 directed AUI to provide a full explanation of STIP in future GRAs and to establish a deferral account to capture differences between Board approved STIP amounts and amounts actually paid out. The Board set out the following:

> In order to clearly understand and assess any future STIP amounts, the Board directs AUI, in future GRAs, to provide a full explanation and details regarding its STIP for each group of employees that are eligible for this incentive. The explanation and details provided are to include, but not be limited to, clear and measurable targets in each key result area, the method by which AUI calculates its forecast STIP amount, and the results that AUI expects in terms of shareholder and customer value. In addition, the Board observes that the president and CEO of AUGI, rather than the president of AUI, must approve the individual objectives set for AUI vice presidents. The Board directs AUI to further address how the involvement of AUGI in approving individual objectives for AUI vice presidents leads to improvements that benefit customers. Future STIP proposals related to targets that are to the benefit of shareholders will not be approved.
>
> The Board considers that the potential exists for not all of the STIP amounts to be paid out. In such a circumstance, shareholders would benefit at the expense of ratepayers. To mitigate this potential, the Board considers that it would be appropriate for AUI to establish a deferral account to capture any differences between the Board-approved STIP amounts, and amounts actually paid out. Therefore, the Board directs AUI to establish a deferral account to capture the difference between the total STIP paid out and the Board approved amount. The disposition of any balance in this account shall be determined in future GRAs.[72] (footnote omitted)

155. AUI submitted that it had complied with the Board's directions in Decision 2007-094 "by being fully transparent in explaining its STIP and providing all the supporting material used internally in implementing its STIP in the GRA Phase 1."[73] Additionally, in respect of establishing a deferral account as per the Board's direction, AUI provided the following table that detailed the STIP amounts as allowed in Decision 2007-094, accrued expenses for 2007 and what was paid out to employees:

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[71] Ex. 47.01, UCA-AUI-16.
[72] Decision 2007-094, p. 35.
[73] AUI Argument, p. 26.

Table 7. 2007 STIP Amounts

		Allowed & Accrued 2007 ($)	[Actual] Expenses 2007 ($)
Salaried		372,500	351,000
Union		242,200	225,600
Executive		109,300	134,700
	TOTALS	724,000	711,300
2008 STIP Adjustment			($12,700)

Source: AUI Application, July, p. 312, Table 1.

Views of AUI and the Interveners

156. UCA had two concerns with AUI's calculation of STIP for the test years:

- AUI had calculated the 2008 STIP adjustment using the actual amount paid under the executive STIP program ($134,700) rather than the allowed amount ($109,300) that was allowed in Decision 2007-094; and
- Although the Board disallowed $62,200 in 2007 with respect to executive STIP, the disallowances had declined to $46,900 and $53,500 in the test year. Moreover, AUI had not provided support for the test year amounts.[74]

UCA submitted that AUI should be directed in its compliance filing, to incorporate a 2008 STIP adjustment of $38,100 and provide details regarding the 2008 and 2009 disallowances for Executive STIP.[75]

157. AUI maintained that it had followed the Board's pronouncements with respect to the deferral account. AUI's interpretation was that "… the total STIP paid out and the EUB approved amount"[76] implied a "single deferral account and treatment of the total STIP amount in aggregate regardless of what class of employee it is paid to."[77] AUI submitted that this treatment complied with the Board's directive and as such this treatment should continue for the test-years.[78]

158. UCA noted that AUI's interpretation did not address the issue that its executive group was paid a STIP amount that exceeded the Board's determination in Decision 2007-094. UCA asserted that since the Board had specifically determined forecast STIP amounts for each group of employees, it therefore followed that the deferral account should function in the same manner.

159. AUI submitted it had excluded from its forecast, portions of Executive STIP that the Board had determined to be shareholder-focused.[79] More importantly, AUI added that its STIP forecasts were made at the "met" level and the amount in excess of the forecast payout for one group may be offset completely or partially by a less than forecast payout for another employee

[74] Ex. 63.02, pp. 15-17.
[75] UCA Argument, pp. 14-15.
[76] Decision 2007-094, p. 35.
[77] AUI Argument, p. 27.
[78] Ibid.
[79] AUI Reply Argument, p. 13.

group that did not meet its STIP objectives. Considering the above, AUI submitted that it was fully compliant with Decision 2007-094 respecting actual 2007 amounts, its forecast test-year STIP amounts, and the operation of its STIP deferral account.

160. CG expressed concerns with AUI's STIP on the basis that STIP-based efficiency gains should result in quantifiable cost savings for the benefit of customers. CG submitted that either (i) a portion of the test-year STIP payments or (ii) a portion of the O&M expenses to recognize the productivity factor for which STIP payments are intended to induce should be disallowed. Therefore, CG recommended that AUI's operating expenses be reduced by $90,000 in each of the test years.[80]

161. AUI acknowledged in cross-examination that it could not quantify STIP-related efficiency gains that translate into cost savings for the rate payers. AUI reaffirmed that any such efficiency gains accrue over time as AUI re-forecasts its staffing and other needs in future test-years. Moreover, AUI stated that its STIP program was primarily customer focused, and as such was not designed to set quantifiable targets leading to quantifiable short-term savings. Accordingly, AUI submitted that CG's recommendation to reduce AUI's forecast STIP or O&M should be rejected.

Views of the Commission

162. The Commission notes UCA's views and AUI's response in respect of 2007 Actual STIP amounts that were provided for AUI's executive group of employees. The Commission also notes that specific payments were set out by the Board in Decision 2007-094 with respect to executive STIP payments:

> Therefore the **Board directs AUI in its compliance filing to reduce the President's STIP** by a total of 36.7%, consisting of a 16.7% reduction for individual goals, in addition to the existing reduction of 20% for financial integrity (which AUI has already excluded from its forecast). Further, **the Board directs AUI to reduce the Vice Presidents' STIP** by a total of 36%, consisting of a 20% reduction for individual goals, in addition to the existing reduction of 16% for financial integrity (which AUI has already excluded from its forecast).
>
> In the Board's view, AUI's proposed STIP is conceptually similar to the short-term incentive plans, which the Board understands are increasingly becoming an integral part of an overall employee compensation packages used by Alberta companies. Given this and the robust labour market that continues in Alberta, the Board considers that it would be appropriate to approve the inclusion of the remaining amounts of AUI's STIP in revenue requirement. Therefore the Board approves AUI's salaried and union STIP forecasts of $372,500 and $339,100.[81] [Emphasis added] [footnotes omitted]

163. Further, the Commission notes the testimony of AUI's witness in regard to STIP:

> A. Mr. Tuele: Oh, in dollars. Mr. Mantei is just referring me to a response, and I trust that it's the right one, AUMA UCA 10 (b), and there it identifies that for executive STIP, the total payout is $171,500, all to expense.
> Now, I should point out also that as indicated in this response, we have not included in our forecast or in our revenue requirement forecast $30,000 for what we're calling

[80] CG Argument, pp. 14-19.
[81] Decision 2007-094, p. 35.

> disallowed executive STIP which would be that portion of the executive STIP program that relates to what have been considered to be shareholder focus objectives.
> Q. So $171,500 is the maximum that could be paid out?
> A. Mr. Tuele: No, that represents, as I understand it, and I'm looking to Mr. Mantei to disagree with me, but he's saying its normal, so it would be the normal payout if the objectives were met at the met level. That would be the payout. **So we're not looking for any payout at the exceptional or exceeded level or any inclusion in revenue**.[82]
> [Emphasis added]

The Commission understands that for 2007 payout at the exceptional or exceeded level would not be included in AUI's revenue requirement, i.e., that customers would not be asked to pay for STIP payments at the exceptional or exceeded level.

164. In consideration of the above, the Commission finds that AUI has not complied with the direction from Decision 2007-094. Further, with respect to Decision 2007-094, the Board determined the specific STIP amounts for each employee group. The granting of a deferral account by the Board does not preclude the specifics of payout within each group. Therefore, the Commission directs AUI in its compliance filing to ensure that $38,100 has been accrued in the deferral account. To be clear, only $109,300 should have been paid out in 2007 in respect of Executive STIP.

165. With respect to the Application, the Commission notes that AUI has stated "AUI's forecast are made at the met level of STIP, if the exceeded level is reached the payouts will be higher than forecast. The amount in excess of the forecast payout for this group may be offset completely or partially by a less than forecast payout for another employee group that did not meet its STIP objectives."[83] This amounts to forecasting STIP at an average payout at the "met" level. The Commission finds this a reasonable approach as this should allow AUI the flexibility to negotiate with its employee groups and to retain and attract the skilled labour it needs to provide safe and reliable service and meet customer needs.

166. The Commission notes UCA's concerns regarding the reduction in executive/director STIP disallowances forecast for 2008 and 2009. However, for purposes of this Decision, the Commission accepts AUI's submission that it has and continues to strictly comply with Decision 2007-094.

167. Considering the above, in order that any future STIP amounts can be clearly understood and assessed, the Commission directs AUI, in its next GRA to provide details regarding its STIP forecast for each group of employees that are eligible for this incentive. Further, the Commission directs AUI to also include the following details as noted in Decision 2007-094:

> The explanation and details provided are to include, but not be limited to, clear and measurable targets in each key result area, the method by which AUI calculates its forecast STIP amount, and the results that AUI expects in terms of shareholder and customer value.[84]

[82] Proceeding 1494406, AUI 2007 General Rate Application Phase 1; Tr. Vol. 1, pp. 93-94.
[83] AUI Reply Argument, p. 13.
[84] Decision 2007-094, p. 35.

4.4 Amortization of Deferred Regulatory Costs

168. AUI provided details of its forecast Deferred Regulatory Costs in Schedule 4.2.4.1 of its First Update. AUI stated that it relied on its experience with the previous Generic Cost of Capital Proceeding in order to prepare its forecast.

> We based it on what we experienced in the previous and gauged it on an approximate adjustment of what we foresaw as a potential for additional work and effort associated with the proceeding.
>
> …
>
> We did not go through the detailed analysis of hourly rates and disbursements to come up with it.[85]

Views of AUI and the Interveners

169. UCA addressed two areas of AUI's proposed deferred regulatory costs:

- AUI's forecast costs totaling almost $620,000 for the Generic Cost of Capital Proceeding; and
- AUI's forecast intervener fees of $155,000 for the 2008-2009 Phase II Proceeding.

170. UCA argued that AUI's estimates were excessive and submitted that AUI's Deferred Regulatory Costs forecast should be reduced by $250,000, consisting of

- a $150,000 reduction to AUI's Generic Cost of Capital Proceeding cost forecast; and
- a $100,000 reduction to AUI's Phase II Proceeding cost forecast.

These reductions would in turn reduce the annual amortization from $698,000 to $573,000.[86]

171. AUI submitted that its forecast for deferred regulatory costs was premised on historical costs actually incurred by AUI in past regulatory proceedings while UCA estimates were arbitrary in nature and totally unsupported by any meaningful data. Further, AUI noted that its regulatory fees and their amortization were subject to deferral account treatment and as such any variance between AUI's forecast and actuals would be adjusted at AUI's next GRA.[87]

Views of the Commission

172. The Commission notes that UCA has not advanced compelling evidence that would convince the Commission to reduce AUI's forecast of regulatory costs. Further, AUI's forecast for deferred regulatory costs was premised on historical costs actually incurred by AUI in past regulatory proceedings. Therefore, the Commission accepts AUI's forecast of deferred regulatory costs for the test years.

4.5 Amortization of Deferred Chief Executive Officer and Chief Financial Officer Certification Costs

173. AUI incurred costs associated with completion of its requirements for Chief Executive Officer and Chief Financial Officer (CEO/CFO) certification. For the test period, AUI forecast

[85] Tr. Vol. 1, p. 61.
[86] UCA Argument, p. 12; Ex. 63.02, p. 15.
[87] AUI Argument, p. 30.

$340,000 in 2008 and $339,900 in 2009 to fully amortize CEO/CFO certification costs by the end of 2009.[88]

174. UCA pointed out that AUI's continuity schedule respecting the amortization of CEO/CFO certification costs showed that the 2009 amortization should only be $314,000.[89] Accordingly, UCA recommended a reduction in 2009 amortization amount from $340,000 to $314,000.[90]

175. AUI concurred with UCA's recommendation.[91]

Views of the Commission

176. The Commission notes agreement between the parties in respect of UCA's proposed reduction to the 2009 amortization of CEO/CFO Certification Costs. Therefore the Commission directs AUI, in its compliance filing to reduce its 2009 amortization of deferred CEO/CFO Certification Costs from $340,000 to $314,000.

4.6 Vehicle Expense

177. AUI's fuel expenses were forecast to increase 20 percent annually during the test years. In its First Update, AUI did not adjust its fuel price expense forecast explaining that

> Fuel prices during 2008 experienced spikes earlier in the year coupled with dramatic decreases at the end. Overall, the costs were virtually as forecast.
> …
>
> As costs in early 2009 are once again on the rise no adjustment to the 2009 Forecast is necessary.[92]

Views of AUI and the Interveners

178. UCA recommended that 2009 fuel expenses be reduced by $157,000 to 2007 cost levels escalated by 5 percent for growth in volumes to reflect the significant reductions in fuel prices since the preparation of the Application.[93] UCA pointed out that its recommendation included a 5 percent growth in volumes for the test period and assumed a return to 2007 fuel prices, which was well above the NYMEX forward price for gasoline at the time the evidence was prepared.

179. AUI indicated that its proposed 2009 vehicle expenses not only included a component related to forecast fuel price increases but also included a component that accounted for the number of new vehicles required for new permanent positions. However, AUI acknowledged that there was a trend toward lower fuel costs and accordingly AUI submitted that it's 2009 forecast fuel expenses less $52,300, or one-third of UCA's suggested reduction of $157,000, should be approved.[94]

88 AUI Application, Schedule 2.5.
89 Ex. 47.01, UCA-AUI-19(c).
90 UCA Argument, pp. 13-14.
91 AUI Argument, p. 14.
92 Ex. 47.01, UCA-AUI-19(a).
93 UCA Argument, p. 15.
94 AUI Argument, p. 28.

Views of the Commission

180. The Commission acknowledges AUI's proposal to reduce 2009 vehicle expenses to account for reduced fuel prices in the test year. The Commission notes that the amount does not account for the use of July 1, 2009 as the start date for new hires in 2009 as directed by the Commission in an earlier section. The Commission considers that the use of this start date would necessitate a slight increase to the proposed fuel cost reduction. However, the Commission has balanced this impact with AUI's submission that fuel "costs in early 2009 are once again on the rise."

181. Additionally, the Commission is not convinced that UCA's proposed reduction of $157,000 to vehicle expenses is warranted. The Commission considers that UCA's methodology to inflate 2007 fuel costs by 5 percent to arrive at its proposed reduction does not adequately take into account the operating realities of the utility. Moreover, UCA's proposed methodology appears to be an over-simplification of the forces impacting fuel costs. On this basis the Commission rejects UCA's recommendation.

182. For the reasons noted above, the Commission finds AUI's proposal to reduce 2009 forecast vehicle expenses by $52,300 to be reasonable. Therefore the Commission directs AUI in its compliance to reduce forecast vehicle expenses by $52,300 for 2009.

4.7 Legal Fees

183. With respect to 2007 actual and 2008 and 2009 forecast legal fees AUI provided the following table:

Table 8. AUI Forecast Legal Fees

	2007 Allowed ($)	2007 Actual ($)	2008 Forecast ($)	2009 Forecast ($)
Legal Fees				
General	80,000	52,000	65,000	94,000
Human Resource	2,000	26,600	26,000	26,000
Totals	82,000	78,600	91,000	120,000[95]

Source: AUI Application, page 193.

Views of AUI and the Interveners

184. AUI submitted that the increase in costs over the test period related "primarily to the increased requirement for legal advice into areas such as privacy and privacy legislation, code of conduct compliance, and increased diligence respecting contractual and other business matters." Further, AUI submitted that "[i]nadvertently, no increase was forecast for human resources related legal activity."[96]

185. When asked to reconcile the proposed increases with its proposal to retain in-house legal counsel, i.e., the position of Regulatory and Legal Affairs Director, AUI submitted that

a. The new hire would not be in place until April 2009 and needed time to get "up to speed" respecting the legal issues that AUI faces;

[95] AUI's 2009 "General" Legal Fee forecast were reduced by $20,000 in the First Update, p. 81.
[96] Ex. 16.01, AUC-AUI-30.

b. Specialized expertise was still required to deal with issues related to labour relations, and land and environment; and

c. The position would be initially focused on primarily providing leadership to the regulatory function.[97]

186. UCA and CG took issue with AUI's 2009 legal fees expense forecast. CG, albeit agreeing that the position of Regulatory and Legal Affairs Director was necessary, expressed concerns that there would be no savings in 2009 as a result of hiring such a resource.

> Given the significant regulatory work load facing AUI in 2009, and considering this new position will be intimately involved in regulatory matters and hearings, it would be reasonable to assume there should be some cost offsets associated with external legal fees …
>
> AUI's own evidence also indicates the new in-house legal resource will be working on other than regulatory and rate related matters.[98]

187. Given the significant regulatory work load facing AUI in 2009, and considering that this new position would be involved in regulatory matters, as well as other areas where AUI had forecast legal costs in 2009, CG suggested that it was therefore reasonable to assume that there would be offsetting costs to the 2009 legal fees expense. Accordingly, CG submitted that AUI's forecast of legal fees[99] should be reduced by $72,000.[100]

188. UCA noted that the Regulatory and Legal Affairs Director job description stated that "there is an opportunity to offset some of these external costs … by having an in-house legal resource that can provide advice and direction on basic legal matters." UCA indicated that it was not unreasonable to expect that legal fees in 2009 could be maintained at 2008 levels as result of retaining internal counsel and submitted that a $29,000 reduction should be made.[101]

189. AUI indicated that the recommendations by CG and UCA if approved, would be punitive in that the resultant 2009 forecast legal fee total would be less than half of what AUI incurred in 2008. AUI reiterated that it did not expect to significantly offset regulatory legal costs in 2009 and that cost offsets in future test periods was uncertain Further, AUI stated that the position was justified on the "need for leadership to the regulatory function and that the position would be involved in directing external legal counsel." In summary, AUI indicated that approval of its forecast amounts, notwithstanding that it incurred $105,500 more legal fees than what was forecast, should be approved.[102]

190. Both CG and UCA submitted that AUI had not substantiated the 2008 increase in external legal fees. UCA reiterated its position that the 2009 external General Legal Fees should be reduced by $29,000.[103] CG submitted that AUI's 2009 legal fees should be reduced by

97 Ex. 47.01, UCA-AUI-19(d).
98 CG Argument, p. 24.
99 Legal fees include "external legal fees in 2009 [that] amount to $240,000 for regulatory proceedings … [as well] as forecast legal fees in 2009 of $120,000 in AUI's O&M expenses."; Ex. 62.01, p. 9.
100 CG Argument, pp. 23-25.
101 UCA Argument, pp. 15-16.
102 AUI Argument, pp. 28-29.
103 UCA Reply Argument, p. 15.

$72,000, being reductions in AUI's proposed 2009 O&M legal fees and Deferred Regulatory Costs by $24,000 by and $48,000 respectively.[104]

191. AUI noted that CG recommendation was based on an arbitrary estimated savings, which was not supported by an analysis or comparable assessment. Further, AUI emphasized that an "opportunity to offset some of these external costs"[105] does not mean that the cost reduction would actually occur.[106]

Views of the Commission

192. The Commission acknowledges AUI's assertion that the new hire would not be in place until April 2009 and needed time to get "up to speed" respecting the legal issues that AUI faces. As a result AUI would still require legal assistance in 2009.

193. While, UCA and CG recommended decreases to AUI's 2009 legal fees, the Commission does not find these arguments compelling because AUI had under forecast its legal costs for 2008. Therefore, the Commission is not convinced that a reduction in legal fees is warranted at this time. Therefore, the Commission accepts AUI's proposed legal fees for 2009 as being reasonable.

4.8 Telephone and Utilities

194. Telephone and utilities included AUI's utility costs for electricity and water as well as all communication costs including voice and data. AUI provided the following table:

Table 9. Telephone and Utilities

	2007 Forecast ($)	2007 Actual ($)	2008 Forecast ($)	2009 Forecast ($)
Head Office Data & Communication Lines	181,400	180,700	187,700	193,800
District and Operations Data & Communication Lines	472,200	505,400	572,000	618,500
Utilities – Electricity, Municipal Water & Sewer	184,100	199,500	211,000	219,200

Source: AUI Application, p. 184.

Views of AUI and the Interveners

195. AUI indicated that it planned to upgrade its system used for communications between its head office, located in Leduc, and its district offices located throughout the province. At the time of the preparation of the 2008/2009 GRA, AUI expected that the upgrade would be completed for the start of the third quarter of 2008;[107] however, in the hearing it was learned that the upgrade will not be completed until the mid-year 2009.[108]

104 CG Reply Argument, pp. 5-6.
105 AUI Application, p. 175, para. 6(d) of Regulatory and Legal Affairs Director job description.
106 AUI Reply Argument, pp. 15-16.
107 Ex. 47.01, CG-AUI-22(a).
108 Tr. Vol. 2, p. 239.

196. CG recommended that AUI "incorporate the capital and operating expenses related to the deferral of the ADSL [Asymmetric Digital Subscriber Line] to WAN [Wide Area Network] upgrade from 2008 to Q2-2009 in its 2008-2009 re-filing application."[109]

197. AUI submitted that CG recommendation was inconsistent with the fixed forward test-year system of regulation that Alberta utilities operate under and the grossing and netting effects that lie at the root of the fixed forward test-year rate setting methodology. AUI submitted that CG's recommendation therefore should be rejected by the Commission.[110]

Views of the Commission

198. The Commission agrees with AUI with respect to the grossing and netting effects of the above. Therefore, for purposes of this Decision, the Commission will allow the amounts proposed by AUI in its telephone and utilities cost forecast for 2008 and 2009.

4.9 Service Restoration – Third Party Gas Supplier System Failure

199. AUI included a one time charge of approximately $100,000 in its revenue requirement for an expense that was incurred to restore service to customers in the Athabasca area after an unplanned interruption of service caused by a NOVA Gas Transmission Ltd. (NGTL) system failure.[111]

Views of AUI and the Interveners

200. The charge was not covered by AUI's insurance policies and the matter was under review by AUI's legal counsel in an attempt to obtain third-party compensation. For its next GRA, CG submitted that AUI be directed to examine the options of obtaining proper indemnification from third-party suppliers and/or provide a cost-benefit assessment of expanding its insurance coverage to include events such as restoration of service following a third-party gas supplier's system failure.[112]

201. In the interim, CG suggested that the Commission disallow recovery of the $100,000 Athabasca loss until such time as AUI has exhausted its appropriate legal recourse. Further, to the extent that AUI may be liable, CG submitted that AUI's shareholders should be responsible for the loss; particularly as such loss might have been minimized through effective indemnification arrangements and/or insurance.[113]

202. Moreover, if the proposed 2008 forecast amount of $70,000 for "Gas Outage" was in regard to an event that should have been covered by insurance or indemnification and was not, recovery of this item consistent with the disallowance of the Athabasca loss event should be denied.[114]

203. AUI clarified that the $70,000 forecast amount cited by CG, was included in the $100,000 total. Further, AUI noted that:

[109] CG Argument, p. 26.
[110] AUI Reply Argument, p. 27.
[111] AUI Reply Argument, p. 28.
[112] CG Argument, pp. 27-28.
[113] CG Argument, p. 29.
[114] Ibid.

all gas shipment on the NGTL system is subject to the NGTL Tariff and more specifically NGTL's published General Terms and Conditions (both are a matter of public record) which contain certain indemnity provisions with respect to gas shipment.

Further, with respect to indemnification by NGTL of shippers on its system the NGTL General Terms and Conditions state in part:

> Company [NGTL] and Customer shall have no liability for, nor obligation to indemnify and save harmless the other from, any claim, demand, suit, action, damage, cost, loss or expense which was not reasonably foreseeable at the time of the act, omission or default; Company [NGTL] shall have no liability to Customer, nor obligation to indemnify and save harmless Customer, in respect of the Company's failure for any reason whatsoever, other than the Company's willful default, to provide Service pursuant to the2 provisions of the Customer's Service Agreement;[115]

204. AUI concluded that CG's submission that AUI should have sought indemnification from NGTL and should do so in the future fails to consider the realities and the nature of gas transmission, including terms of shipment, in Alberta. Moreover, to suggest that AUI was in some way culpable for a pipeline failure on the NGTL system or for failing to extract an indemnity from NGTL is untenable.[116]

205. AUI submitted that, considering the above, there is no point in conducting a study to examine indemnification options from third-party gas suppliers. However, AUI stated that it would investigate the cost to obtain insurance for future test years that would cover similar costs as those AUI sought to recover in its 2008 revenue requirement. AUI submitted that the actual costs associated with the restoration of service to customers in the Athabasca area, in 2008 as well as the forecast amount relating to general gas outages, are costs that were prudently incurred in the provision of utility service and properly belong in its 2008 revenue requirement.

Views of the Commission

206. The Commission agrees with AUI that it would be unreasonable to conduct a study to examine indemnification options from third-party gas suppliers considering the terms of the shipment with NGTL. However, in consideration of the possible benefits that may accrue to customers the Commission finds CG's submission reasonable that AUI investigate the cost to obtain insurance for future test years that would cover similar costs as AUI is seeking to recover in its 2008 revenue requirement.

207. Therefore, the Commission directs AUI in its next GRA to examine the options of obtaining proper indemnification from third-party suppliers and to provide a cost/benefit analysis of expanding its insurance coverage to include events such as restoration of service following a third-party gas supplier's system failure. The assessment should include but not be limited to:

a. the number of third party gas suppliers on AUI's system;
b. the number of such occurrences in the last 15 years where a third-party's gas supply system has failed;
c. a breakdown of costs actually incurred to repair and remediate service to customers;

[115] AUI Reply Argument, pp. 28-29.
[116] AUI Reply Argument, p. 29.

d. details respecting any direct or indirect costs incurred by customers due to loss of service; and
e. subsequent recoveries (if any) from the gas supplier(s).[117]

208. The Commission finds that the actual costs associated with the restoration of service to customers in the Athabasca area in 2008 were prudently incurred in the provision of utility service and properly belong in AUI's 2008 revenue requirement. Therefore, the Commission rejects CG's recommendation to disallow recovery of the $100,000 Athabasca loss until such time that AUI has exhausted its appropriate legal recourse. However, the Commission directs AUI, at its next GRA, to include details of the outcome of its attempt to get compensation from the third-party which caused the damage.

4.10 Contractor, Materials, and Other Costs

209. AUI indicated that this category of expenses included contractor charges, and material and supplies that were required to operate and maintain the natural gas distribution system except for those acquired as Inter-affiliate for Profit services.

4.10.1 Compressor Rental

210. AUI indicated that in 2007 a rental compressor was installed at a single location in order to offset the need to loop the Pincher Creek transmission due to declining source pressures in that line.[118]

Views of AUI and the Interveners

211. CG pointed out that the forecast compressor rental charges appear to be made without an identification of specific locations where they would be required in the test period. Considering that compressor rentals were not required in either 2005 or 2006 CG recommended the Commission use an average between the $0 expended in each of 2005 and 2006 with the actual amount of $50,900 incurred in 2007 to arrive at a test period expense forecast. Accordingly, CG submitted that the Commission should reduce AUI's forecast compressor rental costs by $45,100 and $46,100 respectively in 2008 and 2009.[119]

212. AUI indicated that a rental compressor was installed to offset the need to loop the Pincher Creek transmission line in response to declining source pressures and that the costs were not included in the 2007 forecast but were incurred. AUI noted that the alternative to the use of a rental compressor was to undertake a significant capital expenditure to loop the Pincher Creek transmission line. In consideration thereof, AUI submitted that CG's recommendation should be rejected.[120]

Views of the Commission

213. The Commission notes that the rental compressor was installed in 2007 to offset the need to loop the Pincher Creek transmission because of declining source pressures in the line. The Commission is in agreement with AUI that the compressor rental used to maintain the necessary delivery pressures in the Pincher Creek gas transmission line is a prudent cost and should be

[117] CG Argument, p. 28.
[118] Ex. 48.01, CG-AUI-28.
[119] CG Argument, pp. 30-31.
[120] AUI Reply Argument, p. 14.

included in AUI's 2008 and 2009 revenue requirement. Further, the Commission notes that if it were to accept CG's recommendation to use an average cost, the resultant cost would likely understate future expenses if required. Therefore, the Commission accepts AUI's compressor rental forecast for the test years.

214. However, the Commission directs AUI in its next GRA to provide details of the actual costs incurred for looping the Pincher Creek transmission line.

4.10.2 Leak Survey

Views of AUI and the Interveners

215. AUI indicated that the $70,300 variance with respect to 2007 actual amounts and forecast leak survey amounts related to "for the most part, the disallowance by the AUC in Decision 2007-094 of a portion of AUI's forecast of these costs."[121] Also with respect to the 2008 leak survey forecast, AUI stated that a) inclement weather during 2008 reduced output and crews were not able to complete the budget leak survey and b) the leak survey contractor had difficulty in acquiring staff and had other commitments. Therefore the leak survey work proposed to be completed in 2008 was deferred until 2009.[122]

216. CG noted AUI's significantly higher forecast of leak survey costs for the test period. CG noted that AUI had not provided any credible evidence in support of the proposed test year increases. CG also noted that 2008-2009 forecasts look very high relative to the actual amounts in prior years. CG submitted that the leak survey forecast for the test years should be based on 2007 actual amounts indexed for an escalation factor. Accordingly, CG recommended the Commission reduce AUI's forecast leak survey costs by $49,950 in 2008 and $89,723 in 2009.

Views of the Commission

217. The Commission notes that AUI did not respond to CG's recommendation to reduce AUI's leak survey costs by $49,950 in 2008 and $89,723 in 2009. Further, the Commission notes that the proposed leak survey forecast for 2008 and 2009 represent year-on-year increases of 31 percent and 20 percent respectively.

218. The Commission agrees with CG's submission:

> The 2008-2009 forecast [leak survey expenses] look very high relative to the actuals in prior years. For example, ignoring the low $43,000 actual expense for 2006, which appears to be an aberration … the average for 2005-2007 is $183,500. Hence, the 2008 [forecast] of $250,500 represents a 36.5% increase.[123]

219. The Commission also notes that in addition to the relatively high leak survey forecast, AUI stated that it had deferred leak survey work not completed in 2008, which was valued at approximately $100,000, to 2009.

220. The Commission finds AUI's leak survey forecast to be high. The Commission considers CG's recommendation that AUI's test year leak survey forecast be based on AUI's total actual leak survey costs ($191,000) incurred in 2007 indexed for an escalation factor to be a more

[121] Ex. 48.01, CG-AUI-28.
[122] Tr. Vol. 2, pp. 243 and 244.
[123] CG Argument, p. 32.

reasonable estimate of the costs. Additionally, the Commission finds its approved 5.0 percent direct capital contractor escalation rate in Section 4.1, to be applicable. Accordingly, the Commission directs AUI, in its compliance filing, to reduce its leak survey forecast by $49,950 in 2008 and $89,723 in 2009.

4.11 Pension – Bargaining Unit and Salaried Employees

221. AUI has a Defined Benefit plan for its bargaining-unit's and salaried employees' pensions. With respect to these plans, the pension expense was determined by an actuary, using the accrual vs. the cash or funding method. Further, all of the required contributions, as determined by the actuary, are paid for by the employer.[124]

4.11.1 Increases in the 2009 Pension Expense and Funding Amounts

222. In its initially filed GRA, AUI's forecast pension expense was $1,097,000 for 2008 and $1,074,000 for 2009. However, AUI subsequently increased its proposed 2009 pension expense amount to $1,540,400 explaining that the increases were necessary due to:

> [a]ctuarial evaluations of the pension reflect the dramatic downturns in the market value of the underlying assets as a result of recent events in the financial markets.[125]

Views of AUI and the Interveners

223. CG noted that Mercer Human Resources Consulting (Mercer) was to undertake a new actuarial study as at September 30, 2008. CG further noted that there had been two or three iterations between Mercer and Alberta Pension, and that Mercer was still working on the changes received from Alberta Pension. Moreover, CG submitted that AUI's own evidence suggested that financial conditions may improve in 2009. In view of the above, CG recommended that AUI should have Mercer prepare another actuarial study as at September 30, 2009. Additionally, CG submitted that AUI's 2009 pension expense forecast be reduced by 50 percent until the recommended 2009 Mercer study is completed and a true-up is implemented.[126]

224. AUI submitted that CG's recommendation should be rejected as it was inconsistent with the fixed forward test year system of regulation under which Alberta utilities operate. AUI further suggested that CG had "cherry picked" one component of AUI's 2009 revenue requirement that was included in AUI's Second Update.[127]

Views of the Commission

225. The Commission notes that AUI updated its pension expense numbers based on the updated Mercer evaluation:

> But Mercer has provided -- the valuation has not been accepted yet, it hasn't been provided, but the indication as far as all the funding and expense, that number was provided by Mercer to us.[128]

[124] CG Argument, p. 36.
[125] Ex. 46, AUC-AUI-38(a).
[126] CG Argument, pp. 38 and 39.
[127] AUI Reply Argument, pp. 29 and 30.
[128] Tr. Vol. 1, p. 198.

The Commission further notes that, to support the updated pension expense forecast, AUI provided a letter that "summarize[d] the 2009 estimated contribution requirements and 2009 estimated expense for the … post retirement benefit arrangements sponsored by AltaGas Utilities Inc."[129]

226. The Commission considers that AUI has adequately supported its updated pension expense forecast and that the undertaking of another actuarial study in 2009 is not necessary. The Commission therefore accepts AUI's updated 2009 pension expensed forecast.

4.11.2 Share of NJD Pension Plan

227. Included as part of AUI's test-year staff benefits expense was an item described as "Share of NJD Pension Plan' in the amount of $5,000 per year.[130] AUI indicated that NJD referred to "a former president of a previous owner of AltaGas Utilities Inc. who has a … supplemental retirement plan [a portion of which AUI is funding] on an ongoing basis."[131]

Views of AUI and the Interveners

228. CG submitted that there appeared to be "no benefit to AUI's customers of funding the SERP [Supplemental Employee Retirement Plan] of a former owner." CG further submitted that the "customer responsibility [was] to fund for future retirement obligations of eligible employees" and that there was no evidence on the record that provided the rationale requiring AUI's customer's to fund the retirement obligations of current or former owners of AUI. CG therefore recommended that the inclusion in AUI's revenue requirement of $5,000 cost in the test years related to the pension liability of AUI in respect of a former president of a previous owner of AUI should be denied.[132]

229. AUI submitted that CG's submission regarding the customer responsibility in respect of retirement obligations should be extended to include future and existing retirement obligations. AUI stated that the NJD pension plan liability stemmed from the regulated activities of AUI and therefore belonged in revenue requirement.

Views of the Commission

230. Similar to AUGI's Supplemental Employee Retirement Plan (SERP) discussed in Section 5.1.1, the Commission considers that this amount would ordinarily be for the account of shareholders as payment would be at the discretion of AUI's Board of Directors as it relates to previous employment of an officer in another company. Therefore, the Commission considers that AUI has not demonstrated to the Commission's satisfaction that the inclusion of this amount should be included in revenue requirement and denies AUI's request. Therefore, the Commission directs AUI in its compliance filing to remove the $5,000 amount in each of the test years from its revenue requirement.

4.11.3 2007 Variance in Pension Expense

231. With respect to pension expenses for the period 2007 to 2009, AUI provided the following table:

[129] Ex. 114.01.
[130] Ex. 47.01, CG-AUI-19.
[131] Tr. Vol. 1, p. 193.
[132] CG Argument, p. 40.

Table 10. Pension Plan Expense for 2007 to 2009

	2007 Allowed ($)	2007 Actual ($)	2008 Forecast ($)	2009 Forecast ($)
Salaried Employees Pension Plan	703,000	593,000	665,000	660,000
Bargaining Unit Employees Pension Plan	355,000	303,000	397,000	406,000
Supplementary Executive Retirement Plan	6,000	35,000	35,000	8,000
Share of NJD Pension Plan		6,300	5,000	5,000
Pension Plans Expense, Table 44	1,064,000	937,300	1,102,000	1,079,000

Source: CG-AUI-19.

Views of AUI and the Interveners

232. AUI indicated that the 2007 actual amounts were lower than the forecast or approved amounts because of an increase in the discount rate used to determine the expense. AUI added, in the context of its 2007 GRA update, that "the impact of the change in the discount rate on pension expense was overlooked in the forecast update that was filed April 26, 2007."[133]

233. CG noted the oversight and submitted that AUI had ample opportunity to correct the overstated 2007 pension variance in its 2007 GRA proceeding. Further, shareholders should not be allowed to profit on inflated costs that AUI failed to correct, when it had the opportunity to do so. Accordingly, CG recommended that AUI refund this amount to customers in the current Application.[134]

234. AUI acknowledged that it made an error in overlooking and not updating its forecast pension expense in advance of or during the 2007 GRA hearing. However, AUI suggested that requiring AUI to refund an amount included in AUI's previously approved revenue requirement would amount to retroactive rate making. For this reason, AUI submitted that CG's recommendation should be rejected.[135]

Views of the Commission

235. The Commission agrees with AUI that the pension plan expense in question is related to a prior test period. The Commission finds that, in these circumstances, it is not prepared to revisit the previously approved rates to adjust for AUI's error with respect to 2007 pension expense in the current test period. Therefore, the Commission rejects CG's recommendation in this regard. However, the Commission expects that AUI will use its best efforts to ensure that all information is kept up to date prior to the close of record of a proceeding in order to prevent future errors of this kind.

4.11.4 Defined Benefit vs. Defined Contribution Plans

236. For 2008 and 2009, pension expense is based on estimates received from actuaries. AUI explained in the Application that most of its employees were members of AUI's Defined Benefit

[133] Ex. 47.01, CG-AUI-19.
[134] CG Argument, p. 43.
[135] AUI Reply Argument, p. 31.

(DB) non-contributory pension plans. AUI's next actuarial valuation was to be made no later than September 30, 2008.[136]

Views of AUI and the Interveners

237. With respect to a comparison of DB and Defined Contribution (DC) plans CG provided the following summary:

> The DB expense determination is extremely complex to understand and based on the evidence in this hearing, results in some dramatic changes in the year-over-year annual pension expense. Complexity aside, the accrual method also yields an expense amount which results in unpredictable swings in the annual Revenue Requirement. Further, as any unfunded liability is required to be paid off in the next 15 years, customers in subsequent years continue to incur a cost related to prior years, in addition to the current service cost.
>
> The computation of the pension expense under the DC Plan does not seem to suffer from the complexities in connection with the DB Pension expense computation. It is simply the contribution rate applied to the employee's payroll and, therefore, is expected to result in a pension expense which is more stable and predictable.[137]

238. CG submitted that AUI should provide, at its next GRA, a comprehensive assessment of the costs and benefits (to both customers and employees) of the DC Plan as compared to the DB Plan being offered to all new employees to ensure the DB Plan was in the best interests of customers.[138]

239. AUI submitted that CG's argument offered a comparison of DB and DC pension benefit plans and constituted new evidence that should be ignored by the Commission.[139]

Views of the Commission

240. The Commission agrees with AUI that the comparisons between DB and DC as provided by CG constitute new evidence which should be tested in a future GRA. Therefore, the Commission rejects CG's proposal to direct AUI to provide a comprehensive assessment of the costs and benefits associated with DB and DC plans.

4.12 Moving Costs

241. AUI's forecast included significant increases with respect to moving expenses for the test-year period. CG submitted that AUI's 2007 actual amounts were $3,400, while for the test period AUI forecast moving costs of $100,000 in each of the test years "to fill new or vacant positions."[140]

242. AUI explained that the 2007 variance (actual of $3,400, compared to a forecast of $50, 000) arose because "its forecast included an allowance for three average cost moves, [and] actual costs were for only one low cost move."[141]

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136 AUI Application, Tab 17 – Audited AUI Financial Statements, p. 18 of 22.
137 CG Argument, p. 46.
138 Ibid.
139 AUI Reply Argument, p. 31.
140 CG Argument, p. 47.
141 Ex. 48.01, CG-AUI-20.

Views of AUI and the Interveners

243. CG noted that AUI, when questioned about the 2008 variance, submitted that two larger moves in 2008 totaled approximately $70,000:

> I [Mr. Mantei] think we've come up with a figure of approximately $70,000 for the two moves that we're aware of. And it's been pointed out to me that we had two other moves. We may have had more of a lesser cost, shall we say. We had two big moves and then probably a couple of small ones, and the two big ones were probably in the neighbourhood of $70,000 combined.[142]

244. Based on four moves per year, assuming two small lower cost moves and two large higher cost moves, and using the 2007 average move cost escalated for the test years, CG recommended that moving costs should be reduced by $44,000 in 2008 and $41,000 in 2009.[143]

245. AUI stated that it had based its forecasts on expected moving costs, the types of positions that it was recruiting for and the expectation that it might need to go out of province for new hires. AUI noted the need for higher level positions would require higher moving costs. As such, AUI submitted that CG's recommendations be rejected and AUI's moving expenses for 2008 and 2009 be approved.[144]

Views of the Commission

246. The Commission finds CG's submission that AUI's moving costs be based on the average of two small lower cost moves and two larger higher cost moves to be an over-simplification of the considerations undertaken by AUI to forecast moving costs. The Commission finds AUI's submission that it based its forecast moving cost assumptions on the types of positions for which it was recruiting and the expectation that it might need to go out of the province for new hires to be reasonable. The Commission accepts AUI's forecasts of moving expenses for 2008 and 2009.

4.13 *Gas Utilities Act* Audit

Views of AUI and the Interveners

247. AUI did not forecast any *Gas Utilities Act* Audit costs for 2008 in the deferred regulatory account. However AUI did forecast $30,000 in external third-party costs to perform the *Gas Utilities Act* Audit in 2009.[145] During the course of the hearing AUI confirmed that it had obtained an exemption from the Commission in regard to its 2009 forecast 2009 *Gas Utilities Act* Audit and as a result AUI would adjust its forecast by removing the $30,000 from its revenue requirement.[146]

248. CG recommended that AUI remove the $30,000 in *Gas Utilities Act* costs from AUI's 2009 forecast.[147] AUI agreed with CG's recommendation.[148]

142 Tr. Vol. 1, p. 204.
143 CG Argument, p. 48.
144 AUI Reply Argument, pp. 32-33.
145 Application, p. 331.
146 Tr. Vol. 2, pp. 219-220.
147 CG Argument, p. 49.
148 AUI Reply Argument, p. 33.

Views of the Commission

249. The Commission acknowledges AUI's agreement with CG's recommendation. Accordingly, the Commission directs AUI in its compliance filing to reduce its revenue requirement by $30,000 in 2009, which arises out of a 2009 *Gas Utilities Act* Audit exemption that AUI obtained from the Commission.

4.14 Consultant Fees and Other

250. AUI indicated that its forecast included $250,000 and $500,000 respectively for 2008 and 2009 related to the provision for consulting services related to International Financial Reporting Standards (IFRS) conversion. AUI indicated that it was working with its AUGI and HGL to complete the IFRS convergence project.[149] In its First Update, AUI revised the IFRS related totals to $112,000 in 2008 and $410,000 for 2009.[150]

Views of AUI and the Interveners

251. CG indicated that AUI must be ready to file IFRS-compliant comparative 2010 financials and questioned whether AUI should have waited for the 2008-2009 test years to undertake its efforts regarding this major undertaking. Further, CG noted the uncertainties regarding the nature and extent of

a. IFRS-compliance requirements and therefore the level of costs to be incurred in the test years, and
b. AUI's collaborative efforts with its affiliates and other in the IFRS convergent project.

252. Considering the above, CG recommended approval of the revised forecast as upper limit placeholder amounts to be backstopped by rate payers, and that AUI should provide at its next GRA:

a. detailed justification for costs actually incurred in 2008 and 2009;
b. details of IFRS-convergence costs shared with its affiliates; and
c. evidence of why it could not leverage off the IFRS-work undertaken by AUGI.[151]

253. AUI indicated that it had provided substantial evidence and details surrounding its forecast expenditures and convergence plan for the implementation of IFRS. Further, AUI stated that its participation on the Commission's IFRS Working Group had provided certainty and clarity respecting the implementation of the regulatory aspects of IFRS.[152] AUI also submitted that there was sufficient evidence that demonstrated that AUI was not incurring IFRS convergence costs of related companies and had already built into its IFRS convergence plan the assistance of its parent AUGI. Moreover, AUI submitted that implied deferral account recommendation made by the CG respecting AUI's forecast IFRS costs did not meet the criteria required to establish a deferral account. Therefore, AUI submitted that CG recommendations should be rejected.[153]

149 Ex. 48.01, CG-AUI-29.
150 First Update, Tab 22, p. 1 of 1.
151 CG Argument, pp. 50 to 51.
152 AUI Argument, p. 30.
153 AUI Reply Argument, p. 16.

254. CG pointed out that AUC Rule 026 - *Rule Regarding Regulatory Account Procedures Pertaining to the Implementation of the International Financial Reporting Standards*, was issued after the end of the after the end of the AUC oral hearing date of May 5, 2009. CG submitted that AUC's Rule 026 should provide AUI greater "certainty and clarity' as far as regulatory compliance requirements. Accordingly, CG recommended that AUI should be directed to identify that portion of its total IFRS compliance costs required to meet regulatory compliance requirements identified in AUC Rule 026.

Views of the Commission

255. The Commission agrees with CG's submission that AUC Rule 026 should provide greater certainty and clarity as far as regulatory compliance requirements related to IFRS. Accordingly, the Commission directs AUI in its compliance filing to specify and explain in detail the amount of its total forecast IFRS costs and to demonstrate that there is no duplication of amounts that are included in its inter-affiliate shared services charges.

5 INTER-AFFILIATE COSTS

5.1.1 Inter-affiliate Charges for Shared Services

256. AUI receives services on a shared cost basis from AUGI for operational purposes (direct services) and access to financial markets for financing purposes (fiduciary services). AUI identified twenty-three functions for which it receives services from AUGI and forecast inter-affiliate charges for shared services provided by AUGI of $2.296 million and $2.803 million in 2008 and 2009, respectively (see Table 11).[154] AUI excluded costs relating to shareholder-focused STIP objectives (non-regulatory costs) of $93,000 and $99,000 in 2008 and 2009, respectively. The forecasts represented increases of $1.145 million and $1.652 million, respectively, over the $1.151 million of such costs allowed in Decision 2007-094.[155] AUI did not update its forecasts for these charges.

257. Operational costs attributed to AUI by AUGI were based on estimates of the percentage of time spent by AUGI employees on AUI related work. The allocations to AUI for operational services averaged 69.52 percent and 69.92 percent in 2008 and 2009, respectively.[156] For financial market service costs allocated to AUI by AUGI a composite factor of 85.18 percent was used for each of 2008 and 2009. This composite driver was based on revenue, assets and capital additions of each of AUGI's operating subsidiaries (see Table 12).

258. AUI is one of four investments in operating companies indirectly owned by AUGI. The other investments are:

a) Heritage Gas Limited (HGL) – 24.9 percent ownership (natural gas distribution),
b) Inuvik Gas Ltd.(IGL) – 33.33 percent ownership (natural gas distribution) and
c) Ikhil Joint Venture (IJV) – 33.33 percent ownership (natural gas production and processing).[157]

154 Ex. 2, Tab 7, p. 223; Tab 15, KPMG Study, pp. 21 and 22.
155 In Decision 2007-094 the Board disallowed inter-affiliate costs in the amount of $0.707 million of the $1.858 million requested by AUI.
156 Refer to Ex. 75, Attachment 1, pp. 2 and 3.
157 AUGI website - http://www.altagasutilitygroup.com/profile.php.

HGL and IGL are owned through AUHI and IJV is owned through another wholly-owned subsidiary, Utility Group Facilities Inc. (UGFI). AUI and UGFI are the only subsidiaries for which AUGI has operating responsibility in addition to financing responsibility; other shareholder partners operate HGL and IGL.[158]

Table 11. Inter-affiliate Charges for Shared Services

	2007 Allowed	2007 Actual	2008 Forecast	2009 Forecast
	$000			
(1) Financial Reporting and Control	9	9	81	248
(2) Tax	1	1	2	2
(3) Human Resources	21	21	13	11
(4) Treasury	166	166	253	297
(5) Corporate Secretary	39	39	1	14
(6) Legal and Regulatory	67	67	187	52
(7) Insurance	99	99	49	56
(8) Internal Audit	22	22	15	17
(9) Executive and Strategy	100	100	192	208
(10) AUI Director Fees	72	72	90	99
Sub-total Direct Services	596	596	883	1,004
(11) Financial Reporting and Control*	606	606	730	1,035
(12) Tax	3	3	22	22
(13) Human Resources	4	4	18	13
(14) Treasury	36	36	53	65
(15) Corporate Secretary	20	20	18	39
(16) Legal and Regulatory	1	1	10	11
(17) Insurance*	128	128	106	112
(18) Internal Audit	1	1	10	12
(19) Executive and Strategy	328	328	310	310
(20) AUGI Director Fees*	49	49	46	49
(21) Financial Analysis and Planning	43	43	134	157
(22) Environment, Health and Safety	8	8	1	1
(23) Information Technology*	35	35	48	72
Sub-total Financial Market Services	1,262	1,262	1,506	1,898
Total Shared Services [159]	1,858	1,858	2,389	2,902
Less: Non-regulatory	(75)	(75)	(93)	(99)
Less: Disallowed	(632)	(632)		
Net Shared Services	1,151	1,151	2,296	2,803
* Includes third party costs				

158 Ex. 2, Tab 15, KPMG Study, p. 13 of 152.

159 For 2008 and 2009 refer to Ex. 2, p. 223; Tab 15, KPMG Study, pp. 21 and 22 (Financial Market Services include third party costs of $743,000 and $1,046,000 in 2008 and 2009, respectively).

Table 12. Calculation of the Composite Allocator – Financial Market Service

	Total Assets ($,000)	Revenues ($,000)	Capital Expenditures ($,000)
AUI	135,093	126,095	15,954
HGL	16,552	2,889	4,590
IGL	2,074	1,839	0
UGFI	8,313	2,608	0
Total	162,032	133,431	20,544
AUI Percentage of Totals	83.37%	94.50%	77.66%
Weighting	1/3	1/3	1/3
AUI Weighted Allocation	27.79%	31.50%	25.89%
AUI Total Allocation	85.18%		

Source: Ex. 2, Tab 7, Table 64, p. 211.

Views of AUI

259. AUI submitted that the services obtained from AUGI were necessary and that, without them, it could not effectively run its business and serve its customers as it lacked expertise in the areas of service provided by AUGI. AUI asserted that AUGI provided those services it required at costs that were generally lower than the costs AUI would incur if it had to obtain the same services independently. AUI concluded that if it performed the services itself, it would be forecasting $3.173 million for 2008 and, using an inflation rate of 5 percent, $3.332 million for 2009.[160]

260. AUI identified three issues relating to the charges for inter-affiliate shared services in this GRA:

a) What standard should be applied in the determination of inter-affiliate costs?
b) What is the appropriate quantum of such costs?
c) Should the no-harm test apply to or affect the determination of inter-affiliate costs for AUI?

261. AUI submitted that the standard used to determine inter-affiliate charges should be the three tests of necessity, reasonableness and prudence. AUI asserted that the costs to be charged to AUI for 2008 and 2009 would not result in harm to customers because:

a) the charges are necessary;
b) the aggregate costs allocated to AUI are reasonable when compared to market, and, are in fact, below the market average;
c) the allocated costs are similar or lower than the costs at which AUI could acquire the services in the market; and
d) performing the services within AUI would be more costly than having the services provided by AUGI and sharing the costs with other entities.[161]

[160] Ibid, Tab 7, p. 218.
[161] Ex. 75.01, pp. 1 and 2 of 3.

262. AUI agreed with UCA's submission, discussed below, that fair market value (FMV) is one test of reasonableness that can be applied to the inter-affiliate services individually or collectively. However, AUI noted that the inter-affiliate costs relate to shared services as defined in AUI's Inter-affiliate Code of Conduct, which stipulates that shared services are to be priced on a cost recovery basis. AUI thus submitted that a determination of the overall reasonableness of the inter-affiliate costs must include not only comparators, such as FMV, but also the requirements of its Inter-affiliate Code of Conduct.

263. AUI asserted that the significance of using the "cost recovery basis" as the standard for pricing shared services is that "market value" is not the requisite test, either for individual services or for all services in the aggregate. AUI added that the test for the use by a utility of an affiliate's services is prudence, as identified in its Inter-affiliate Code of Conduct.

264. AUI noted that in its 2007 GRA proceeding it provided quantified evidence in the form of a 2006 AIT Pro-Forma of Inter-affiliate Shared Services costs (2006 AIT Pro Forma) showing AIT inter-affiliate services provided on the basis of full cost recovery. AUI considered that the 2006 AIT Pro-Forma continues to be compelling evidence of the existence of a subsidy that was conferred on AUI by AIT prior to the 2005 reorganization.

265. AUI noted that it had engaged KPMG LLP (KPMG) to review the proposed inter-affiliate shared service charges to be made by AUGI to AUI and, more specifically, to assess the necessity of the services provided to AUI, the reasonability of the allocation methodology used and the reasonableness of the costs involved (KPMG Study).[162]

266. AUI asserted that the various criticisms of the KPMG Study made by UCA were unfounded and submitted that:

- KPMG did complete an independent review of the inter-affiliate shared services and costs by starting with the information provided by AUGI and AUI and then ensuring that the information was factual and accurate but without completing a formal audit of the information provided;
- the KPMG Report is based on the scope approved by AUI management and the allocation methodology applied in this Application and AUI's 2007 application was consistent with the allocation methodology applied prior to the existing AUGI ownership;
- the KPMG Study provides the results based on current market research and on the actual AUGI/AUI structure and costs forecasted for 2008/09; and
- KPMG's engagement with AUI was not to assess costs and benefits in relation to a no-harm test as defined for regulatory proceedings but was to report on the necessity of the services provided by AUGI to AUI, the reasonability of the allocation methodology and the reasonability of costs associated with those services.

267. AUI submitted that KPMG, using its own tests, which included an assessment of market value, concluded that the inter-affiliate shared services costs forecast to be allocated to AUI were reasonable. AUI further submitted that this conclusion, together with AUI's own legal assessment of the Administrative Services Agreement with AUGI and confirmation that the agreement was compliant with AUI's Inter-affiliate Code of Conduct, satisfied AUI that taking

[162] Ibid, Tab 15.

the services on the terms and conditions offered by AUGI would be prudent and compliant with the standard provided in AUI's approved Code of Conduct.

268. In responding to the concerns raised by UCA regarding STIP included in the inter-affiliate cost allocations, AUI stated that the 2008/2009 forecast AUGI CEO STIP individual objectives included only one category that was shareholder focused and the other three STIP objective categories were not shareholder focused. AUI further stated that including the 2008/2009 forecast one STIP individual objective shareholder related category for the CEO and all corporate objectives for all AUGI staff, the amount of the inter-affiliate charges to AUI that relates to shareholder STIP is $139,099 in 2008 and $147,484 in 2009. AUI noted that when the 2008/2009 forecast for the inter-affiliate shared costs was prepared in early 2008, the AUGI staff 2009 forecast individual STIP objectives were the same as those set for 2008, whereas the actual 2009 AUGI CEO and CFO STIP objectives, set in late 2008 subsequent to the filing of the Application, include two out of four STIP objectives as shareholder related. AUI also noted that the actual 2009 STIP individual shareholder related category for the CEO and two for the CFO, increased the amount of the inter-affiliate charge to AUI that relates to shareholder STIP by $19,544, to $167,028.

269. AUI submitted that it is common for senior executives that move from one organization to another, whether the organizations are related or not, to be given consideration for their years of service at their previous organization. Consequently, AUI considered that the full costs of the CEO's SERP entitlement should be included when determining the costs associated with the inter-affiliate shared services.

270. AUI disagreed with UCA's suggestion that costs associated with the CFO position should be disallowed, as AUI submitted that it had received, and continues to receive, all of the services that it requested as part of the administrative services agreement. AUI noted that the services that were previously provided by the CFO who left the position were still being provided, albeit by a slightly different mix of people and the costs associated with receipt of the services continue to be incurred by AUI.

271. For purposes of determining the inter-affiliate composite allocation factor AUI disagreed with UCA's submission that the cost of gas sold be excluded or that HGL's revenue deficiency account (RDA) be included. AUI stated that as it is a default supplier of natural gas it must have access to financing that is adequate to pay for the gas it purchases. Thus, AUI submitted that not including such a major financing requirement for AUGI's subsidiaries in the determination of the composite allocation factor would be illogical. AUI stated that the HGL RDA revenue represents non-cash revenue and, therefore, for AUGI's financial market needs, the RDA is not a factor.

272. AUI submitted that the Board failed in Decision 2007-094 to recognize the positive impact on customers of the reduction in AUI insurance costs that resulted from the 2005 Transaction (this was one of the bases for a review and variance filed by AUI). As a result, AUI considered that the 2007 base for total inter-affiliate services – shared cost should have been no lower than $1,633,764 and that this was the minimum amount from which the costs for 2008 and 2009 should be viewed. With respect to the concern raised by UCA regarding insurance cost allocations, AUI advised that AUGI took over responsibility for arranging for AUI's insurance from August 1, 2006 onwards. Other subsidiaries however obtain their own insurance directly.

Views of the Interveners

273. CG agreed with and supported UCA's submissions and recommendations on inter-affiliate charges for shared services.

274. UCA expressed its concern with the magnitude of the increases in inter-affiliate charges for shared services since the 2005 reorganization. UCA noted that the increases in these charges for 2008 and 2009 amounted to 330 percent and 430 percent, respectively, since 2006 when AIT provided the services. Consequently, UCA considered that financial harm to customers has resulted from the 2005 reorganization and that the no-harm principle was not time sensitive. UCA submitted that the no-harm principle should continue to be recognized and applied at least in this proceeding. UCA disagreed with AUI that the increases in these charges were also a result of an unintended subsidy conferred on AUI in the past by AIT.

275. UCA also disagreed with AUI's assertion that EUB decisions have specifically constrained the application of the no-harm test to the first case subsequent to determination of harm and that the test will be subsumed within the normal examination of regulatory applications. UCA submitted that the Commission is not bound in this proceeding by precedent. More particularly, UCA submitted that none of Decision 2005-112,[163] Decision 2007-094 or Decision 2008-079, each of which specifically addressed the no-harm principle with regard to the 2005 reorganization, contains any language to suggest time sensitivity. UCA also submitted that the Commission should consider the Application based on the specific circumstances regarding financial harm to AUI's customers that may have resulted from the 2005 reorganization rather than the circumstances applicable to other utilities as set out in another decision.[164] AUI considered that the burden of proof to prove that no harm has been caused to customers of AUI as a result of the 2005 reorganization lies with AUI.

276. UCA also disagreed with AUI's assertion that the no-harm standard should not and cannot operate to preclude the recovery of inter-affiliate costs reasonably incurred and allocated to AUI for the provision of necessary services, as UCA considered that the inter-affiliate charges were not reasonable. UCA recommended that the charges first be adjusted to no more than FMV, which is the test for reasonableness, and then that amount should be further adjusted to reflect the change in allocation resulting from the 2005 reorganization and used by the EUB in the 2007 GRA.

277. UCA referred to the background and regulatory treatment regarding AUI's inter-affiliate shared services charges since 1998 to refute AUI's general assertion that the increases those shared services costs resulted from a correction of an unintended subsidization of AUI's customers by AUI's previous owner, AIT. UCA submitted that the inter-affiliate shared services costs charged by AltaGas Services Inc. (ASI) [predecessor to AIT] to AUI commencing in 1998 were higher than those previously charged by another previous owner of AUI, Westcoast Energy Inc., and that ASI initially absorbed a portion of those costs. UCA further submitted that it is not uncommon for parent companies to provide shared services in order to maintain control over their investments, the cost of which should not be borne by the utility's customers. Additionally,

[163] Decision 2005-112: AltaGas Utility Holdings Inc., Request for Approval of Share Transfer (Application No. 1408750) (Released: October 14, 2005).

[164] Refer to Decision 2003-061: AltaLink Management Ltd. Transmission Tariff for May1, 2002 – April 30, 2004 and TransAlta Utilities Corporation Transmission Tariff for January 1, 2002 – April 30, 2002 (Released: August 3, 2003).

UCA questioned whether the cost increases in shared services involved an unintended subsidy by AIT or a less efficient organizational structure in AUGI.

278. UCA noted that in 2006 AIT charged AUI $255,000 for fiduciary (financial market) services, using an allocation rate of 21.45 percent and that AUGI has proposed to charge $1.506 million in 2008 and $1.898 million in 2009 for similar services, which represented increases of 490 percent and 643 percent, respectively, over the 2006 amount. UCA submitted that the 21.45 percent allocation of these financial market costs to AUI, based on the pre-2005 reorganization allocation that the EUB utilized in Decision 2007-094, should be maintained. However, UCA excluded third party costs for insurance, information technology and AUGI directors' fees from its recommended reductions based on the AIT model. Consequently, UCA recommended reductions of $352,000 and $544,000 for third party costs[165] and $571,000 and $638,000 for employee costs for 2008 and 2009, respectively.

279. UCA compared AUI's inter-affiliate shared services costs with corporate services charges made by ATCO Ltd. to ATCO Gas[166] as a reasonableness benchmark. UCA found that the impact of AUGI inter-affiliate costs was 440 percent greater for AUI customers than ATCO corporate services costs were for ATCO Gas customers. UCA considered that, as this percentage comparison with ATCO Gas was close to the increase in costs in AUI resulting from the 2005 reorganization, the efficiency of the structure of AUGI to provide inter-affiliate services to AUI was brought into question. Based on the above benchmark to ATCO Gas Corporate Service costs, UCA submitted that a detailed review of the inter-affiliate shared services costs allocated by AUGI to AUI is warranted to determine why they are so high relative to those charged by ATCO Ltd. to ATCO Gas and by AIT to AUI prior to the 2005 reorganization.

280. UCA noted that AUI's business activities represent a significantly greater portion of AUGI's investment portfolio as compared to its position within the AIT group prior to the 2005 reorganization. UCA stated that the significance of this change is that AUGI is unable to benefit from the economies of scale and staff specialization of a larger company such as AIT.

281. UCA noted that the Administrative Services Agreement (ASA) between AUGI and AUI does not provide for adjustments from amounts forecast to be charged to AUI by AUGI for inter-affiliate shared services and amounts actually incurred during the 2008 and 2009 years. UCA was concerned that in a situation where the actual inter-affiliate shared services costs are less than those forecast, AUGI would recover more costs under the ASA than those actually incurred to the detriment of the customers of AUI. UCA was also concerned that a material business acquisition by AUGI, subsequent to determination of the allocation factor for inter-affiliate shared services costs, would result in a greater proportion of Financial Market Services inter-affiliate costs being allocated to AUI than would otherwise be appropriate. Therefore, UCA recommended that where a material business acquisition is made by AUI between GRAs that is not considered in the calculation of the allocation factor of Financial Market inter-affiliate shared services costs, a deferral account be set up to adjust for any discrepancy that may arise.

282. UCA considered that the KPMG Study did not adequately deal with the inter-affiliate shared costs issues raised in respect of the Application. More particularly, UCA contended that KPMG did not address concerns raised by the Board in Decision 2007-094 in respect of KPMG's prior review of inter-affiliate charges for AUI not being a fully independent study and

165 Ex. 130.03, IR response AUC-UCA-1(d).
166 ATCO Gas is a division of ATCO Gas and Pipelines Ltd., an indirect subsidiary company of ATCO Ltd.

in making a comparison of allocation methodology used by AUGI with that used by AIT and appeared to lack supporting quantitative analysis or benchmarking. Also, UCA considered that KPMG should have considered the no-harm principle that was outlined in Decision 2005-112 and any potential efficiencies in the inter-affiliate shared service costs that may have been realized by AUI under the notional scenario whereby the 2005 reorganization did not occur. UCA noted that KPMG's determination of reasonableness in assessing inter-affiliate charges did not consider AUI's prominent position within the AUGI group of companies.

283. UCA identified the following additional concerns regarding the KPMG Study:[167]

(a) Were the 23 services identified, as "Operational Services" or "Financial Market Service" actually necessary for the operation of AUI?
(b) Are the costs incurred by AUGI and allocated to AUI reasonably and prudently incurred?
(c) Is the method of allocation of these costs between AUGI's subsidiaries reasonable?
(d) Are the AUGI salary-related costs reasonable having regard to market conditions?

284. UCA was concerned about the accuracy of the KPMG Study, noting that a significant number of the conclusions were based on information provided to KPMG by AUGI. In this regard UCA also noted that AUGI employees did not keep time sheets, that the information about full time equivalent employee (FTE) by service was provided by AUGI and that KPMG could therefore not comment with certainty that the inter-affiliate services enumerated were required or even provided to AUI.

285. UCA also questioned the validity of the data used by KPMG to compare the reasonableness of AUGI's costs. In evaluating KPMG's salary source data UCA considered that KPMG's findings included calculations based on arbitrary and unsubstantiated inputs. Consequently, UCA concluded that the KPMG Study did not rationalize the substantial increase in the charges for inter-affiliate shared services and therefore had limited usefulness.

286. UCA disagreed with a conclusion made in the KPMG Study that the charges for inter-affiliate shared services, when reviewed as a basket of services, were reasonable compared to market and alternative means for provisioning these services. UCA submitted that need for and cost of each AUGI inter-affiliate shared service allocated to AUI should be addressed separately.

287. UCA were concerned with the level of compensation of AUGI's CEO/CFO that was proposed to be charged to AUI. Based on a study of executive compensation that it undertook, UCA provided its determination of the CEO/CFO of AUGI compensation that was in excess of market:[168]

[167] UCA Argument, Section 2.9.5, p. 29.
[168] UCA Argument, p. 36.

Table 13. UCA Determination of 2008 and 2009 CEO and CFO Compensation

2008 Forecast		Median of Public Company Proxies $	Variance
AUGI CEO Compensation	927,862	503,000	424,862
AUGI CFO Compensation	373,471	296,000	77,471
	1,301,333	799,000	502,333
Percentage of salaries allocated to AUI -69.52%			349,222
Rounded			349,000
2009 Forecast			
AUGI CEO Compensation	989,133	536,215	452,918
AUGI CFO Compensation	395,555	313,503	82,052
	1,384,688	849,718	534,970
Percentage of salaries allocated to AUI -69.92%			374,051
Rounded			374,000

288. Consequently, UCA submitted that CEO/CFO base salary, STIP and other compensation otherwise to be allocated to AUI be reduced by $349,000 and $374,000 in 2008 and 2009, respectively.

289. Based on its analyses of AUGI's costs, UCA also recommended the following reductions in charges allocated to AUI:

- Short-term incentive plan (STIP) – $19,500 in 2009
- Supplemental executive retirement plan (SERP) – $73,000 in each of 2008 and 2009
- STIP for the CFO – $63,000 in 2008

290. Because of the timing for the filling of the CFO vacancy in 2009, UCA also recommended that the difference between the Controller's salary and STIP over the last seven months of 2008 and the forecast salary plus STIP for the CFO should be removed from the AUGI costs allocated to AUI in 2008 and that re-calculation of compensation amounts involving that position should be made in AUI's compliance filing.

291. UCA expressed three concerns with the allocation of Financial Markets Shared Services Costs from AUGI to AUI:

- inclusion of cost of gas and purchased power, to address the costs of fluctuating commodity prices,
- use of 2006 data rather than 2008 or 2009 data, as the data was not up-to-date, and
- exclusion of revenue deficiencies from HGL, as deferred revenues are no different than current revenues.

292. UCA recommended that Business development costs first be directly assigned to that function and the remaining FMV for AUGI inter-affiliate shared services costs, after taking into consideration the no-harm standard, should be allocated to the operating utilities using the most

up-to-date data available, excluding the cost of gas but including HGL's revenue deficiency account. Based on its recommendations UCA determined that the allocation factor would be reduced to 83.60 percent. However, UCA's recommendation regarding cost allocation methods was subject to its over-riding recommendation, which reflected the no-harm standard.

293. In evaluating the evidence filed by AUI in this proceeding regarding the reduction in insurance costs attributable to the 2005 Transaction, UCA submitted that it considered $122,800 as the appropriate reduction in insurance premiums resulting from the 2005 Transaction. UCA expressed concern about the allocation of insurance premiums between AUI and AUGI because of the apparent lack of costs for insurance being charged to any other affiliate.

Views of the Commission

Decision 2007-094 and No Harm

294. In its 2007 GRA, AUI forecasted inter-affiliate shared services costs of $1,858,510. In Decision 2007-094, the Board concluded that the 2005 Transaction had resulted in AUI receiving a greater allocation of these costs than it had prior to the 2005 Transaction:

> The Board finds that due to the Transaction, AUI will receive a much greater allocation of inter-affiliate shared costs. As indicated by AUI, prior to the Transaction, AUI was allocated 21.45% of fiduciary costs, based on AUI's total assets as a percentage of the total assets of all of ASI's businesses. The Board finds that as a result of the Transaction, AUI's customers will experience an additional cost of $632,573, as demonstrated in Table 56 of the Application, given that there has been a significant change to the asset base on which fiduciary costs are allocated to AUI.[169]

295. Finding that financial harm had occurred as a result of the 2005 Transaction,[170] the Board determined it was necessary to mitigate that harm, and disallowed that portion of AUI's forecast 2007 inter-affiliate shared services costs associated with the change in allocation from 21.45 percent to 91.40 percent, or $632,573. This effectively allowed AUI 56.78 percent of AUGI's forecast inter-affiliate services shared costs (before STIP amounts were deducted).[171]

296. In this Application, AUI argued that the assessment of harm resulting from the 2005 Transaction should be limited to the first GRA subsequent to that transaction. In support of this position, AUI cited an excerpt from the Board's findings in Decision 2003-061,[172] which related to the Board's assessment of harm in considering the effects of a sale transaction involving AltaLink Management Ltd. (AltaLink), approved by the Board in 2002:

> For a utility that has been operating over a longer period, the Board considers that each application before it will deal with the specific costs presented and measure the fairness and reasonableness of those costs against the needs and history of performance as presented in evidence by all parties. Following this decision, AltaLink will have received considerable guidance and direction that will form the basis of their future applications. As such, once these initial decisions have been rendered, the Board considers that the concept of harm beyond the initial sale and GTA application, with few exceptions, will

169 Decision 2007-094, pp. 50-51.
170 Decision 2007-094, p. 51.
171 (($1,858,509-$632,573)/$2,159,231).
172 Decision 2003-061: AltaLink Management Ltd. and TransAlta Utilities Corporation, Transmission Tariff for May 1, 2002 – April 30, 2004; TransAlta Utilities Corporation, Transmission Tariff for January 1, 2002 – April 30, 2002 (Application Nos. 1279345, 1279347, and 1287507) (Released: August 3, 2003).

> be subsumed in the usual review of rate and related applications that a utility makes in the course of its regulatory life.[173]

297. AUI also cited Decision 2005-019,[174] a subsequent decision in which the Board addressed the issue of harm arising as a result of the 2002 AltaLink sale transaction. In particular, AUI cited the following excerpt:

> (…) The Board agrees in particular that a key aspect of the Decision 2003-061 passage is the notion that the review of the no harm test would be "subsumed" within the normal examination of AltaLink regulatory applications. Such normal consideration is intended to be contrasted with the potential that the Board might overturn the sale transaction itself as a consequence of a finding of harm arising as a result of the sale. While such a prospect was considered to be unlikely at the time of the issuance of Decision 2003-061, the possibility that additional factors might be brought to light that would cause the Board to overturn the sale transaction have become even more unlikely with the additional passage of time. Accordingly, the Board considers that if there is a finding of harm, adjustments that might be made to mitigate against such harm should generally occur in the normal course, and might include actions such as adjustments to AltaLink revenue requirement forecasts.[175]

298. Although acknowledging the subsuming of the no harm issue into the normal examination of regulatory applications, in this passage the Board considered that if a finding of harm was made, but the Board was not convinced that the transaction causing the harm should be overturned or unwound, then an ongoing mitigation of the harmful effects may occur "in the normal course", and might include adjustments to forecast revenue requirements.

299. This is further borne out in a subsequent decision issued in 2007,[176] where the Board yet again addressed the matter of harm resulting from AltaLink's 2002 sale transaction. In particular, the Board commented on AltaLink's obligation, on the basis of the no-harm principle, to ensure that average productivity levels were not demonstrably worse off as a result of the 2002 transaction.[177]

300. The Commission considers that these decisions support the proposition that although a finding of harm may have occurred in the past, the Commission must assess the available evidence to determine whether mitigation of harm is to be required on an ongoing basis. The Commission considers that this process is one that will necessarily evolve over time, as new facts and evidence are brought forward.

Subsidization – Level of Costs Should be Higher

301. In its 2008-2009 GRA, AUI forecast inter-affiliate shared services costs of $2.296 million and $2.803 million in 2008 and 2009, respectively. AUI asserted in this proceeding, as it did in its 2007 GRA, that the increases in its inter-affiliate shared costs from 2006 amounts were not in

173 Decision 2003-061, p. 8.
174 Decision 2005-019: AltaLink Management Ltd. and TransAlta Utilities Corporation, 2004-2007 General Tariff Application (Application No. 1336421) (Released: March 12, 2005).
175 Decision 2005-019, p. 19.
176 Decision 2007-012: AltaLink Management Ltd. and TransAlta Utilities Corporation, 2007 and 2008 Transmission Facility Owner Tariff; AltaLink Management Ltd., Settlement of Self Insurance Reserve Account for Period May 1, 2004 to December 31, 2005 (Application No. 1468229) (Released: February 16, 2007).
177 Decision 2007-012, p. 82.

fact increases as a result of the 2005 Transaction; rather, AUI submitted that the forecast costs reflected the proper level of charges as the inter-affiliate charges allocated by AIT prior to the 2005 reorganization had been unintentionally subsidized by AIT and did not reflect the amounts that it should have charged for the services rendered.

302. In support of this position, AUI considered that the KPMG Study supported the level of its inter-affiliate shared services costs. AUI also noted the 2006 AIT Pro Forma filed in the 2007 GRA as evidence in support of this position, as well as the testimony of an AUI witness confirming his view on the subsidization.

303. The Board was not persuaded by this argument in making its findings in Decision 2007-094 and it did not accept the evidence (neither the KPMG study filed in that proceeding, nor the 2006 AIT Pro Forma) as being persuasive in support of the increases in inter-affiliate shared costs forecast in that proceeding.

304. The Commission is still not persuaded by AUI's assertion of an unintentional subsidy, nor by the evidence that AUI has submitted in support of the unintentional subsidy. There is no conclusive evidence before the Commission that AIT actually subsidized AUI in the past. Further, for the reasons set out below, the Commission does not accept that the form of the KPMG Study filed in this proceeding supports AUI's position that an unintended subsidy existed in past GRAs. Nor can the Commission rely upon the opinion of an AUI witness on this point without further substantiating evidence to validate the quantum of the alleged unintentional subsidy.

Assessing the Costs

305. AUI's Inter-affiliate Code of Conduct (Code) provides that shared services are to be priced on a cost recovery basis (section 2.1 (v)). AUI's Code defines cost recovery basis with respect to the use of shared services by a utility of an affiliate's services as meaning "the complete costs of providing the service, determined in a manner acceptable to the utility, acting prudently" (section 2.1 (l)).

306. Section 3.3.4 of AUI's Code provides that AUI must periodically review the prudence of continuing shared services arrangements with a view to making any necessary adjustments to ensure that each of AUI and its affiliates bears its proportionate share of costs.

307. The Code operates to anticipate and adjust for the potential misalignment of interests between shareholders and customers of AUI. It is in this context that the Commission must assess the reasonableness and the prudence of AUI's inter-affiliate shared services costs.

Reasonableness and the KPMG Report

308. As noted above, AUI retained KPMG to perform an independent review of the services and reasonableness of the costs related to the Operation Services and the Financial Market Service. KPMG acknowledged that its approach to the 2008/2009 cost allocation review did not differ significantly from the approach towards the same review in 2007.[178]

309. In support of the reasonableness of the inter-affiliate shared services costs, AUI submitted that KPMG, using its own tests, which included an assessment of market value,

[178] Application, Tab 15, p. 4 of 152.

concluded that the inter-affiliate shared services costs forecast to be allocated to AUI were reasonable.

310. The Commission has reviewed the KPMG Study and continues to have the same concerns expressed by the Board in Decision 2007-094, particularly surrounding the issue of determining the quantum of time and attention actually spent by AUGI employees on AUI matters. In Decision 2007-094, at page 53 the Board stated:

> The KPMG review was not a fully independent study, in terms of analyzing all salary and position information through their own review and assessment, but rather relied on information from management. While it is acceptable to rely on basic data from management of AUI, the Board notes the comments of MGCI in argument that KPMG should not have accepted the duplicative strategy services in both the direct executive charges and the fiduciary executive charges; rather KPMG should have assessed timesheets themselves on an independent basis. The Board agrees and considers that any future reports of this nature should clearly differentiate services and ensure there is no duplication.

311. The Commission notes that in arriving at its conclusions for the KPMG Study filed in this GRA, KPMG has substantially relied on information obtained from AUGI's employees and not through a form of time analysis which could be placed in evidence and tested by the Commission. However, KPMG indicated that in the absence of actual time tracked, management estimates of work effort in consultation with staff is an accepted approach and results in a reasonable level of accuracy.[179] The Commission considers that in the absence of evidence on the record outlining the time spent by AUGI's employees on AUI-related business, the question remains as to the extent to which AUI needs or benefits from all of the services of AUGI's full complement of employees.

312. As noted above, in assessing AUI's 2007 GRA, the Board expressed concerns about the inter-affiliate costs that AUGI proposed to charge to AUI and which AUI proposed to include in revenue requirement. More particularly, in Decision 2007-094 the Board, in reference to a study for fiduciary services, stated that "… AUI should address the issue of whether management time and attention should be considered in the allocation formula."[180] The Commission considers that the Board was inferring that a detailed review of time actually spent on AUI's affairs would essentially be in order.

313. In this GRA AUI chose not to provide specific details through time records in respect of the actual amount of time that employees of AUGI have spent on providing services to AUI but instead has relied on generalized approximations such as the "basket of services" approach outlined in the KPMG Study and the use of time estimates provided by AUGI management that the Commission could not test in the context of the GRA.

314. The Commission continues to have concerns about the magnitude of the inter-affiliate charges proposed and considers that AUI has not adequately demonstrated to the Commission's satisfaction that the package of inter-affiliate charges requested by AUI reflects the amount of services that AUI would ordinarily require on an annual basis vis-à-vis its ongoing capital and operational requirements.

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[179] Application, Tab 15, p. 12 of 152.
[180] Decision 2007-094, p. 55.

315. The Commission notes KPMG concluded that the quantum of shared services costs forecast by AUGI for 2008 and 2009, for operational services and financial market service were reasonable when compared to market and alternative means for provision of these services, subject to certain exceptions it identified, when taken in the aggregate (a basket of services). The Commission has no reason to disagree with KPMG's overall conclusion about the market value of the services when reviewed as a whole. On this basis the Commission considers that AUGI's costs that were forecast for 2008 and 2009 are not unreasonable as a total package.

316. However, the Commission cannot agree with the premise that a "basket of services" approach is the proper method to be applied in determining the reasonableness of the inter-affiliate shared service charges that should be included in AUI's revenue requirement for 2008 and 2009.

317. Further, the Commission considers that the KPMG Study again failed to independently or otherwise adequately demonstrate that all of the allocated charges associated with inter-affiliate shared services in AUGI are properly or reasonably for the benefit of AUI. Similarly, the Commission also continues to have the same misgivings identified by the Board with respect to the methodology that was used by AUGI to allocate charges for inter-affiliate shared services to AUI for rate making purposes in AUI's 2007 GRA. In that GRA, these concerns of the Board resulted in the effective reduction of AUI's applied for inter-affiliate shared costs of approximately 50 percent of AUGI's 2007 forecast amount.

318. In light of the Commission's continued concerns regarding the manner in which AUI has supported its inter-affiliate shared costs, the Commission can not accept AUI's forecasts of $2.296 million and $2.803 million in 2008 and 2009, respectively, for these services as being reasonable or prudent. In the face of increases of approximately $1.14 million for 2008 and $1.65 million for 2009 over the Board-approved total for these costs in 2007, the Commission considers that continued mitigation of harm by adjusting AUI's inter-affiliate shared services costs is warranted.

319. The Commission does not however fully accept UCA's recommendations regarding the use of a 21.45 percent allocation factor. The Commission considers that the use of the AIT allocation factor proposed by UCA would not necessarily provide for the cost of reasonable services that would be required to meet the needs of AUI, absent the necessary expertise of staff in AUI. While UCA did not summarize its recommendations using the 21.45 percent allocation factor, it would appear that any resulting inter-affiliate charges would be less than $1 million in each of 2008 and 2009, which would result in a greater reduction than the Board approved in 2007.

320. In Decision 2007-094, the Board determined that financial harm had occurred and a reduction of $632,573 was warranted given the negative impact on customers arising from the substantial increase in costs subsequent to the 2005 Transaction. The effective result of the disallowance was a reduction of approximately 50 percent to AUI's inter-affiliate fiduciary (financial market service) costs. In this proceeding, the Commission notes that the views proffered by each party on inter-affiliate shared service charges are essentially the same as those expressed in respect of AUI's 2007 GRA. Further, the Commission also notes that inter-affiliate service charges have substantially increased subsequent to the 2005 Transaction without demonstrable support from AUI for the quantum of the increases.

321. The Commission finds that there is no compelling evidence presented by any party that would suggest that the Commission should deviate from the Board's position in Decision 2007-094 wherein the Board considered that the charges were excessive. Therefore, for the 2008 and 2009 test years, the Commission considers that a reduction in AUI's forecasts of inter-affiliate shared service charges, exclusive of amounts for STIP or SERP, is warranted. To calculate the reduction, the Commission directs AUI in the compliance filing to reduce its forecast of charges for inter-affiliate shared services to the level that represents the average percentage of AUGI's total costs that were allowed before the STIP charge in 2007. Based on Attachment 1, page 1 of 3 of Exhibit 75, the Commission has determined this average percentage to be 56.78 percent.[181] The Commission directs AUI in the compliance filing to include in its revenue requirement only 56.78 percent of AUGI's operation service and financial market service costs forecast for 2008 and 2009 as inter-affiliate shared service costs for AUI.

322. In applying this percentage reduction, the Commission acknowledges and agrees with UCA's submission that the labour costs associated with the CEO and CFO appear excessive relative to market conditions, and notes that this was also identified in the KPMG Study. However, for purposes of this Decision the Commission will not require a further reduction to AUI's inter-affiliate shared service charges for any excess associated with these labour costs.

323. The Commission notes the evidence filed in this proceeding by both the UCA and AUI with respect to the positive benefits that have resulted from reduced insurance premiums. While the UCA and AUI disagree on the quantum of that benefit, both AUI and UCA appear to recognize that some benefit may have accrued to AUI as a result of a reduction in insurance costs. Just as it has determined that it will continue to mitigate for the harm resulting from the 2005 Transaction, the Commission considers that it should also recognize a benefit of reduced insurance costs resulting from the 2005 Transaction for the purposes of the 2008 and 2009 test period, based on this new evidence.

324. By letter dated January 19, 2009, AUI provided information with respect to its inter-affiliate shared costs, which included information on insurance costs. The Commission has estimated the amount of insurance benefit resulting from the 2005 Transaction, using mid-year calculations, as follows:

Table 14. Commission Estimate of Insurance Benefits

	($)
Actual amount of insurance expense for 2005 (Ex. 50)	813,800
Actual amount of insurance expense for 2006 (Ex. 50)	671,000
	671,000
Mid-year	(a) 742,400
Actual amount of insurance expense for 2006 (Ex. 50)	671,000
Actual amount of insurance expense for 2007 (Ex. 50)	472,500
	1,143,500
Mid-year	(b) 571,750
Difference (a) - (b)	(c) 170,650

181 ($1,858,509-$632,573)/$2,159,231.

325. The Commission finds that the mid year difference of $170,650 is a reasonable proxy for the insurance savings arising from the 2005 Transaction. This amount calculated as a proportion of the mid-year insurance expense prior to the 2005 Transaction provides an effective benefit of approximately 23 percent. For purposes of this Decision, the Commission considers that this benefit should be applied to adjust AUI's 2008 and 2009 forecast insurance costs. The Commission finds that 23 percent of AUI's forecast 2008 and 2009 insurance expense should be added to revenue requirement to give effect to this benefit and directs AUI in the compliance filing to make this adjustment.

326. The Commission notes that AUI excluded costs relating to shareholder-focused STIP objectives (non-regulatory costs) of $93,000 and $99,000 in 2008 and 2009, respectively. The Commission is satisfied that AUI properly excluded costs relating to shareholder-focused STIP from its inter-affiliate costs. However, the Commission notes that the final determination of any non-allowed STIP amounts will be subject the Commission's above direction for the reduction in inter-affiliate charges.

327. With respect to SERP entitlements proposed to be included in charges for inter-affiliate services, the Commission is of the view that any consideration for years of service at a previous organization given to an employee in an executive position in AUGI would be at the discretion of the directors of AUGI and therefore should not be borne by customers of AUI. Therefore, similar to shareholder related STIP costs, the Commission considers that SERP costs should be excluded from inter-affiliated shared service costs allocated to AUI by AUGI. The Commission therefore directs AUI to exclude any SERP expense in each of 2008 and 2009 from amounts of inter-affiliate shared services to be included in revenue requirement.

328. The Commission is aware that AUI will be paying ongoing fees to AUGI for management or other services rendered. The actual amount of those fees that are paid to AUGI on an annual basis is ordinarily not subject to the Commission's determination, unless those fees were to affect the viability of AUI's utility services. However, it is the duty of the Commission to review and assess the reasonableness of the amounts of any such inter-affiliate charges that AUI proposes to be included in its rates. Therefore, because the magnitude of the inter-affiliate shared service fees to be included in AUI's revenue requirement is clearly an ongoing issue the Commission directs AUI, for purposes of its next GRA to provide:

- detailed analyses of the time, charges and description of the services provided for each of the specific operational and financial market services to be rendered by each of the AUGI employees;
- specific details of third party costs incurred by AUGI, which AUI proposes to include in its forecast of revenue requirement for the costs for those services;
- a detailed explanation of the cost drivers of any increases for each specific operational and/or financial market service;
- a detailed explanation of the allocation of CEO and CFO costs between operational and financial market service
- identification of any changes to the methodology of allocating inter-affiliate costs compared to previous applications; and
- an evaluation of the reasonableness of the inter-affiliate costs as per each individual service instead of a conclusion based on a basket of services approach.

329. The Commission also notes that AUI asserted that the significance of using the "cost recovery basis" as a standard for pricing of shared services is that "market value" is not the

requisite test either for individual services or for all services in the aggregate. AUI added that the test for the use by a utility of an affiliate service is prudence, as identified in its Code. Although the Commission agrees that the test for shared services is that the costs incurred are shown to be prudent, FMV may be utilized in the Commission's evaluations of whether or not a utility acted prudently. The Commission notes that section 3.3.4 of AUI's Code provides that AUI must periodically review the prudence of continuing shared services arrangements with a view to making any necessary adjustments to ensure that each of AUI and its affiliates bears its proportionate share of costs. AUI is therefore directed to in the compliance filing to explain why, for the purposes of inclusion in AUI's revenue requirement, receiving services from an affiliate is prudent especially wherein the costs of that service may be above FMV.

330. The Commission considers that the increased level of detail could be applied, for example, as subsets to the various descriptions of services set out on page 21 of the KPMG study. In this manner the Commission expects that AUI will be able to address more particularly the reasons for the costs of the shared services it expects to be procuring from AUGI and allow parties to properly test AUI's proposals.

5.1.2 Inter-affiliate Charges for Profit

331. AUI contracts with two affiliated companies for services, which include gas management and operations, meter calibration and repair, odorant supply and delivery, and corrosion control. AUI forecast costs for inter-affiliate charges for profit of $345,000 and $354,000 in 2008 and 2009, respectively.

Table 15. Inter-affiliate Charges for Profit

	2007 Allowed	2007 Actual	2008 Forecast	2009 Forecast
	$000			
Gas Management and Operation	195	186	193	198
Less: Charged to Deferred Gas Account	(136)	(130)	(135)	(139)
Net Gas Management and Operation	59	56	58	59
Odorant Delivery	146	127	136	140
Cathodic Protection Surveys	85	7	39	40
Anode Replacement - Labor	50	31		
Master Testing and Repair - Labor	94	108	112	115
	375	273	287	295
Total Inter-affiliate Charges for Profit	434	329	345	354

Views of the Commission

332. The Commission notes that no party took issue with AUI's forecasts of inter-affiliate charges for profit and thus will accept AUI's forecasts. The Commission also notes that AUI's Inter-affiliate Code of Conduct states:

> When a Utility acquires For Profit Affiliate Services, it shall pay no more than the Fair Market Value of such services. The onus is on the Utility to demonstrate that the For

> Profit Affiliate Services have been acquired at a price that is no more than the Fair Market Value of such Services.[182]

For purposes of AUI's next GRA, Phase I, the Commission directs AUI to demonstrate that any inter-affiliate charges for profit included in its forecasts have been priced at FMV.

6 INCOME TAXES

333. AUI uses the flow-through method to determine its income tax expense for regulatory purposes. Under this method, AUI is to determine the least amount of income taxes that would be payable on the income it forecast for the test years concerned. Income taxes are normally determined in accordance with legislation as it exists at the time. However, in respect of forecasts for prospective test years, where proposed changes in legislation that will affect those years are expected to be enacted, the changes are used in the income tax calculations.

334. For regulatory purposes, the income taxes included in revenue requirement would only be the same as the actual income taxes paid by the utility if the forecast was identical to the actual income recorded in the utility's accounts for the year concerned. As income taxes are not accorded deferral account treatment there is certain risk for the amounts of income tax included in the revenue requirement.

335. For 2008 AUI forecast income tax expense of $1.249 million in the Second Update. For 2009 AUI forecast no taxable income. However, in doing so, AUI reduced the discretionary claim for capital cost allowance (CCA) on certain classes of assets by approximately $2.2 million.

Views of AUI and the Interveners

336. UCA agreed with CG on the following matters concerning income taxes:

- a) a deferral account to capture changes in rates may be appropriate in principle because changes between forecast rates and rates ultimately enacted for the test year may not be minor,
- b) a deferral account for both 2008 and 2009 is necessary and justified to ensure all tax losses are captured,
- c) AUI should claim maximum CCA in 2009 to create a tax loss and apply a loss carry-back to 2008,
- d) at its next GRA AUI should be directed to provide a detailed assessment why it is not capitalizing any capital maintenance projects and if capitalized why such projects do not meet Rainbow tax criteria,[183] and
- e) at its next GRA AUI should be directed to provide a detailed study or assessment of the nature of costs capitalized by ATCO Gas and claimed as deductions in the year incurred for income tax purposes by ATCO Gas and Pipelines Ltd.[184]

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[182] AltaGas Utilities Inc. Inter-Affiliate Code of Conduct, Approved by the Alberta Energy and Utilities Board January 5, 2005, section 4.2.1, p. 8.

[183] Rainbow tax criteria refer to principal factors considered, which are listed at page 23 of 30 (electronic version) in *Rainbow Pipeline Company, Ltd. v. Her Majesty the Queen*, 1999 TCC 964369 at para 31, in helping to determine the deductibility of amounts capitalized for accounting purposes that would be deductible in the year incurred for income tax purposes.

337. CG submitted differences between actual and forecast tax and/or CCA rates cannot always be treated as being minor, citing for example, the 2009 Federal Budget announcement of a "temporary 100 % capital cost allowance rate for computers acquired after January 27, 2009, and before February 1, 2011" which would result in additional CCA for AUI of $624,660 in 2009. Grossed up for the "tax on tax" impact, the 2009 Revenue Requirement could be decreased by $255,142. CG therefore recommended that a deferral account be set up for AUI for 2008 and 2009 to incorporate all changes in income tax and CCA rate changes announced in either the Federal and/or Alberta budgets or in any economic updates/statements announced subsequent to these budgets. CG also submitted that the primary intent of an income tax rate deferral account was to avoid a windfall gain or loss to AUI. To further support the use of a deferral account CG noted that some budget announcements may take months or years to receive legislative approval.

338. Further, CG submitted that if a deferral account makes sense in principle, that principle should not be a function of when a utility's final rates are fixed, as proposed by AUI. Rather, a deferral account would allow those changes in tax rates to be captured during the test years as and when announced, while ensuring customers and the utility are kept whole in the event any announced changes are not fully enacted before the end of the test years. CG listed the following criteria that supported the use of a deferral account:

a) an amount resulting from a tax rate change is difficult to forecast as it not within the control of management,
b) the impact on costs stemming from a Federal/Alberta budget cannot be forecast with any degree of accuracy, and
c) the amount in question may be material in nature.

339. CG noted that in 2009 AUI forecast no taxable income by claiming only that amount of CCA required to being the 2009 taxable income to nil. CG submitted that use of the flow-through method for determining income taxes requires that CCA claims be maximized in a year Therefore, CG recommended that AUI claim maximum CCA in 2009, create a tax loss and apply the loss as allowed by income tax law to the forecast for 2008. CG further noted that the income tax expense, and consequently revenue requirement, for 2008 would be reduced accordingly.

340. CG was concerned with AUI's inconsistent capitalization policy regarding capital maintenance projects and whether or not any amounts that should be capitalized would be eligible for deduction in the year incurred for income tax purposes. CG also questioned AUI's capitalization of other general and administration expenses and whether or not such capitalized amounts have been also been properly reviewed for eligibility for deduction in the year incurred for income tax purposes. CG cited the *Rainbow*[185] and *Canderel*[186] tax cases as references to determine the deductibility of capitalized expenses for income tax purposes.

341. CG submitted that AUI should be directed to provide, as part of its next GRA, a detailed assessment demonstrating why any capital maintenance projects do not meet the Rainbow tax criteria. CG also submitted that AUI should be directed to provide, as part of its next GRA, a

184 ATCO Gas is not a tax paying corporation but is a division of ATCO Gas and Pipelines Ltd., which is a taxpaying corporation.
185 Supra note 183.
186 *Canderel Limited v. Her Majesty the Queen),* [1998] 1 S.C.R. 147.

detailed study or assessment of the nature of costs included in the additional tax deductions for running costs claimed by ATCO Gas pursuant to the *Canderel* tax case and the tax treatment accorded by AUI to such costs. CG considered that such a study should result in AUI reporting on why it should or should not apply the immediate tax deduction treatment to the additional costs identified by ATCO Gas (i.e., related to vehicle and heavy equipment operating costs, non direct labour costs, stock handling costs, payroll burden and fringe benefits).

342. AUI disagreed that a deferral account should be set up to reconcile any proposed changes in income tax rates that are announced by the Federal or Alberta governments. AUI noted that in each of AUI's 2005-2006 GRA and its 2007 GRA the Board rejected the use of such a deferral account. AUI submitted that there has been no change in facts subsequent to the Board's last rejection of the use of a deferral account to address changes in tax policy or legislation, as again proposed in this proceeding. AUI further noted that for 2008 there were no differences in tax or capital cost allowance rates as between forecast and actual rates and that in 2009 AUI forecast no income tax expense.

343. AUI disagreed with CG that AUI has any capital repairs or capital maintenance projects to which the *Rainbow* tax criteria should be applied. AUI submitted that the only expenditures that are effectively treated in accordance with the Rainbow tax criteria are reclamation costs.

344. AUI also disagreed with CG's suggestion that AUI conduct a study of running costs claimed by ATCO Gas pursuant to the *Canderel* tax case to determine whether ATCO Gas' treatment of such costs for income tax purposes should be followed by AUI. AUI stated that it has not been a participant in any proceeding involving tax issues of ATCO Gas. Accordingly, AUI submitted that CG's suggestions have no evidentiary foundation and if they were accepted would lead to a breach of natural justice and would result in an error of law.

Views of the Commission

345. The Commission disagrees with CG's proposal for a deferral account for income tax rates to be set up by AUI to provide for the possibility of a change in income tax rates that would affect the 2008 and 2009 test years. The Commission notes that in Decision 2007-094 the Board rejected a similar recommendation made by the Consumers' Coalition of Alberta. The Commission is aware that a deferral account for income tax rates has been approved for other utilities. However, at this particular time the Commission considers that any announced changes made by either of the Federal or Alberta governments subsequent to the issue of this Decision would not have any material effects on the provisions for income taxes forecast by AUI for purposes of this Application.

346. The Commission notes that AUI did not maximize the use of CCA in its 2009 forecast of income taxes, which would have had the effect of creating a non-capital loss that could have been applied to reduce the 2008 income tax expense. Unless otherwise approved by the Commission, the use of the flow-through method to determine income taxes mandates that all available deductions that would be allowed under income tax laws are to be claimed in order to minimize the income tax component included in revenue requirement. Therefore, the Commission directs AUI in its compliance filing to minimize its income tax expense forecast in 2008 and 2009 in accordance with the Federal and Alberta income tax laws that have been enacted, or that may be viewed as being substantially enacted, for those years.

347. The Commission will not require AUI to conduct studies to determine the availability of deductions for income tax purposes of expenses that have been capitalized for regulatory purposes. Further, the Commission will not require AUI to contact ATCO Gas regarding running expenses claimed by ATCO Gas for its income tax purposes, as the particular circumstances applying to ATCO Gas may or may not be similar to AUI's and would be difficult to generalize. The *Rainbow* and *Canderel* tax cases cited by parties highlight the controversial nature of establishing the distinction between expenditures that may result in capital outlays or deductible expenses for income tax purposes. Accordingly, the deductibility of such expenditures to be incurred by AUI, should be reviewed by a qualified income tax specialist as they are ultimately subject to assessment by the Canada Revenue Agency. The Commission also considers that while the distinction can be difficult to determine on an incurred basis, this difficulty is increased on a forecast basis as the nature of a capital project to be undertaken may not be known until it has been started or even completed. In this regard, the Commission expects that AUI will use its best efforts to determine that all available deductions will be taken in determining the income tax provisions used in its forecasts.

348. Notwithstanding these views, the Commission considers that in the future there may be merit in establishing a deferral account to reconcile variances that may arise in dealing with expenditures that are capitalized for regulatory purposes but deducted for income tax purposes in the year incurred. On this basis the Commission directs AUI in the compliance filing to comment on the suitability of such a deferral account as it may apply to AUI.

7 DEPRECIATION AND AMORTIZATION

349. AUI included depreciation expense for the plant accounts included in Intangible Plant, Transmission Plant, Distribution Plant, and General Plant is calculated utilizing the rates as approved by the Board in AUI's previous GRA proceeding for the 2005/2006 test years. As in the case with the 2007 GRA an additional technical update for 2008 and 2009 AUI conducted and the results reflected in this Application.[187]

Views of the Commission

350. The Commission notes that depreciation and amortization expense was not raised as an issue by any party. However, the Commission also notes that depreciation and amortization expense forecast by AUI for 2008 and 2009 would be subject to any changes made to forecasts affecting rate base. Therefore, the Commission directs AUI in its compliance filing to adjust depreciation and amortization expense accordingly to reflect changes to forecast capital expenditures in 2008 and 2009 as directed in this Decision.

8 COST OF CAPITAL

8.1 Rate of Return

351. AUI's forecast of cost of capital for 2008 and 2009 was based on a capital structure using a debt-to-equity ratio net of contribution and grants of 59:41, as approved by the EUB in Generic

[187] Ex. 2, Tab 21.

Cost of Capital Decision 2004-052.[188] For purposes of the Application, AUI proposed the 59:41 debt-to-equity ratio also apply to 2009.

352. AUI incorporated a rate of return on common equity (ROE) of 8.75 percent for 2008 based on the approved rate set by the EUB in Order U2007-347[189] and, in the Second Update, utilized the same ROE on common equity as a placeholder for 2009 pursuant to the direction of the Commission in its letter dated December 1, 2008 to participants in the Generic Cost of Capital Proceeding.[190]

353. Neither CG nor UCA objected to the proposed use of 8.75 percent as a rate of return placeholder for 2009.

Views of the Commission

354. The Commission accepts AUI's use of the 59:41 debt-to-equity ratio for 2008 as well as the rate of return placeholder of 8.75 percent for 2008 as per Order U2007-347. As ROE and capital structure matters for 2009 are subject to a separate determination by the Commission in the Generic Cost of Capital proceeding, AUI's compliance filing pursuant to this GRA decision is to be filed only after a decision has been rendered by the Commission in the Generic Cost of Capital proceeding. Any findings that may be made in the Commission's decision in respect of the Generic Cost of Capital proceeding that are relevant to AUI's 2009 ROE and capital structure will be applied for the purpose of determining AUI's final revenue requirement for 2009.

8.2 Cost of Debt

355. For the 2008-2009 test period, AUI identified its debt structure as consisting of two debentures in the amount of $30 million each. One debenture, issued in 2003 (2003 debt), matured in May 2008 while the other debenture, issued in 2005 (2005 debt) matures in October 2010. AUI's 2005 debt has an approved debt cost rate of 5.44 percent. In the Application AUI included $30 million of new debt (2008 new debt) at an estimated cost rate of 7.000 percent as a placeholder for the matured 2003 debt, and also included intermediate term debt (intermediate debt) to reflect AUI's additional financing requirements. AUI submitted that its total debt reflects AUI's total financing requirements on a mid-year basis equal to AUI's approved debt ratio of 59 percent of rate base net of no-cost capital. AUI's debt financing is obtained through AUHI, which in turn obtains financing through AUGI. The cost of debt for AUGI is less than the proposed financing rates ultimately charged to AUI.

356. In the Second Update AUI provided the following Table, which sets out its actual 2007 and revised forecasts for its 2008 and 2009 embedded cost of debt.[191]

188 Decision 2004-052: Generic Cost of Capital - AltaGas Utilities Inc., AltaLink Management Ltd. ATCO Electric Ltd. (Distribution), ATCO Electric Ltd. (Transmission), ATCO Gas, ATCO Pipelines, ENMAX Power Corporation (Distribution), EPCOR Distribution Inc., EPCOR Transmission Inc., FortisAlberta (formerly Aquila Networks), NOVA Gas Transmission Ltd. (Application No. 1271597) (Released: July 2, 2004)

189 Order U2007-347: Board Initiated Proceeding, 2008 Generic Return on Equity Formula Result (Application No. 1548232) (Released: November 30, 2007).

190 Commission initiated proceeding, Application 1578571, ID 85.

191 Ex. 78.

Table 16. Embedded Cost of Debt

2007 Allowed

Line	Principle	Rate	Principal December 31 2006	Principal December 31 2007	Average 2007 Principal	Average Interest Expense	Embedded Cost of Debt
1	2003 Debt	6.000%	30,000,000	30,000,000	30,000,000	1,800,000	6.000%
2	2005 Debt	5.440%	30,000,000	30,000,000	30,000,000	1,632,000	5.440%
3			60,000,000	60,000,000	60,000,000	3,432,000	5.720%

2007 Actual

Line	Principal	Rate	Principal December 31 2006	Principal December 31 2007	Average 2007 Principal	Average Interest Expense	Embedded Cost of Debt
4	2003 Debt	6.000%	30,000,000	30,000,000	30,000,000	1,800,000	6.000%
5	2005 Debt	5.440%	30,000,000	30,000,000	30,000,000	1,632,000	5.440%
6			60,000,000	60,000,000	60,000,000	3,432,000	5.720%

2008 Forecast

Line	Principal	Rate	Principal December 31 2007	Principal December 31 2008	Average 2008 Principal	Average Interest Expense	Embedded Cost of Debt
7	Intermediate	7.000%	-	-	7,631,555	534,209	7.000%
8	2003 Debt	6.000%	30,000,000	-	15,000,000	900,000	6.000%
9	2005 Debt	5.440%	30,000,000	30,000,000	30,000,000	1,632,000	5.440%
10	2008 New Debt	7.000%	-	30,000,000	15,000,000	1,050,000	7.000%
11			60,000,000	30,000,000	67,631,555	4,116,209	6.086%

2009 Forecast

Line	Principal	Rate	Principal December 31 2008	Principal December 31 2009	Average 2009 Principal	Average Interest Expense	Embedded Cost of Debt
12	Intermediate	7.000%	-	-	16,397,371	1,147,816	7.000%
13	2005 Debt	5.440%	30,000,000	30,000,000	30,000,000	1,632,000	5.440%
14	2008 New Debt	7.000%	30,000,000	30,000,000	30,000,000	2,100,000	7.000%
15			30,000,000	30,000,000	76,397,371	4,879,816	6.387%

357. In response to an undertaking, AUI provided its actual embedded cost of debt for 2008.[192]

Table 17. 2008 Actual Embedded Cost of Debt

2008 Actual							
Line	Principal	Rate	Principal December 31 2007	Principal December 31 2008	Average 2008 Principal	Average Interest Expense	Embedded Cost of Debt
1	Demand note	5.820 %	8,233,700	10,000,000	9,116,850	530,601	5.820%
2	2003 Debt	6.000%	30,000,000	-	15,000,000	900,000	6.000%
3	2005 Debt	5.440%	30,000,000	30,000,000	30,000,000	1,632,000	5.440%
4	Bridge financing	6.820%	-	37,057,200	18,528,600	1,263,651	6.820%
5			68,233,700	77,057,200	72,645,450	4,326,252	5.955%

358. Based on evidence brought forward in the oral hearing, AUI sought revisions to the Application and submitted the following:

- that it was seeking approval of its actual contracted debt costs, meaning the removal and replacement of the 7 percent placeholder with the short-term borrowing rates as contracted between AUI and AUHI,
- that the closing balance of borrowings for 2008 be the opening balance for 2009, consisting of $10 million at an annual cost rate of 5.4 percent, $40 million at an annual cost rate of 6.0 percent and $30 million existing debenture at a cost rate of 5.44 percent,
- that the 2009 closing balance should consist of the existing $30 million debenture plus a $60 million dollar debenture at a cost rate of 7.00 percent, and
- that in the event the debenture is not issued, the existing contracted short-term issues of $10 million at an annual cost rate of 5.4 percent and $60 million at an annual cost rate of 6.0 percent (contracted borrowing amounts) plus the $30 million debenture at a cost rate of 5.44 percent would be used.[193]

Views of AUI

359. In argument, AUI stated that the cost of debt to AUI should be its appropriate cost of debt on a stand alone basis, whether that is deemed or actual. In principle, AUI was opposed to the idea that AUGI debt costs should be mirrored down to AUI (through AUHI).

360. AUI submitted that, in the past, the regulator has accepted the stand alone concept meaning that a subsidiary's debt costs are not determined by mirroring down the rates incurred by a parent. AUI cited its 2005 debenture application, which was the subject of Decision 2006-049,[194] as an example of the stand alone concept. AUI noted that in the 2005 debenture application the cost of debt to the parent (then AIT) was 4.41 percent and while AUI sought approval of a rate of 7.05 percent for a debenture on the basis of its determination of its stand alone debt cost, the EUB approved a cost of 5.44 percent on the basis of its differing

[192] Ex. 114, Tr. Vol. 1, p. 89, l. 25.
[193] AUI Argument, p. 59.
[194] Decision 2006-049: AltaGas Utilities Inc., Request for Approval of Debenture Issue (Application No. 1426643) (Released: May 24, 2006)

interpretation of the appropriate cost of debt for AUI. AUI submitted that the Board did not accept the position of interveners that the debt cost should not exceed the 4.41 percent cost to AIT and did not take the position that the debt cost to AUI should be the same as the debt cost to AIT.

361. AUI submitted that mirroring down for utilities other than AUI has typically, if not exclusively, been done with respect to long-term debt of the parent that is mirrored as long term debt to the utility. AUI considered that where arrangements and rates for long-term debt can be directly and symmetrically mirrored down, it may be practical to do so but, by contrast, mirroring down of short-term financing from the parent to the utility would be unworkable because the various elements of the debt involved are seldom, if ever, symmetrical. As an example AUI stated that if AUGI were to need another $10 million dollars from its borrowing syndicate then the terms of its financing agreement would cause the rate on the entire line of credit to go up, not just on the $10 million. So if the rate on AUGI's “old” debt is mirrored down to AUI, and it suddenly goes up for AUGI, the result is either that the parent bears the higher rate or AUI has to correspondingly raise its rates. AUI submitted that this type of situation does not provide needed stability for customers and, in any event, the regulatory lag would make it unfair to AUGI, even if AUI was allowed to increase rates. AUI thus maintained that short-term borrowings are dynamic in terms of duration, rates, the need to reopen or renew, and other factors so it is wrong to mirror them down.

362. AUI asserted that UCA and CG arguments on mirroring down the AUGI financing costs to AUI ignore the other relevant terms and conditions of the financing contracts that impact the costs of the related financings. AUI noted that the cost of a financing contract includes terms in addition to the underlying interest rate that must be considered when determining the total costs involved. AUI listed the following factors: the term of the facility, the covenants of the facility, the creditworthiness of the parties, other fees in the facility, and the market conditions present when the facility is obtained.

363. AUI submitted that the short-term borrowing agreements between AUI and AUHI relate to “for profit” affiliate services and have been entered into in compliance with AUI’s Inter-affiliate Code of Conduct (Code of Conduct), which stipulates that the test for pricing is “fair market value.” AUI further submitted that the debt agreements acknowledge that they are “Services Agreements” within the meaning of the Code of Conduct and being short-term, those agreements do not require AUC approval under the Code of Conduct or the *Gas Utilities Act.* For AUI the question was whether or not its cost of debt reflects fair market value.

364. AUI submitted that the rates in the RBC Royal Bank of Canada (RBC) letter which were used in the short-term financing agreements are the best evidence of the fair market cost of debt to AUI as a stand alone utility and that the debt pricing of the RBC can hardly be questioned on grounds of expertise, or bias. AUI noted that the RBC declined to file a *curriculum vitae* for the official who had signed the letter dated March 26, 2009 because the statements made in the letter were those of the RBC as an institution and not of its employee. AUI also noted that other major banks were part of AUGI’s banking syndicate and that the RBC had assured AUI that those other banks would have provided the same information. AUI submitted that the negotiated and contracted rates between AUI and AUHI should be accepted for determining debt costs to be included in its revenue requirement for 2008 and 2009 as they fall within the range suggested by the RBC, which was as follows:

1) $10 million demand operating line: BA margin of 350-400 bps; Prime + 250-300 bps; standby fee of 70-80 bps on the unused amount; and upfront fee of 50 bps.
2) $60 million 1-year term revolving facility: BA margin of 400-450 bps; Prime 300-350 bps; Standby fee of 120-135 bps; and upfront fee of 100 bps payable at closing.[195]

365. AUI stated that UCA's suggestion that AUI's witnesses in the Generic Cost of Capital Proceeding confirmed that its short-term borrowings and those of AUGI were the same was a mischaracterization and thus incorrect. AUI provided further excerpts of testimony from that proceeding to clarify that AUI's short-term borrowings would not be the same as for AUGI.

Views of the Interveners

366. CG noted that AUI's current position that its cost of debt should be the cost of debt on a stand alone basis has not been a consistent, long standing position of AUI. CG noted that AUI's financing for the years 2001 to 2003 reflected the actual financing of its parent, AUHI, with a mirroring down approach to AUI and that predecessor corporations of AUI, such as Centra Gas, were historically responsible for financing the utility requirements with the actual costs of debt reflected in the capital structure and revenue requirements.

367. CG noted that for purposes of its test year capital structure and revenue requirements, AUI used deemed long-term debt at higher interest rates, which were substantially greater than the actual cost of debt of AUGI. CG submitted that as AUGI is financing the utility operations, AUI is effectively provided with a higher equity return. Alternatively, CG suggested that AUI, in selecting a deemed approach, could finance its utility operations with lower cost short-term debt from its parent.

368. CG was concerned that AUI's cost of financing included in revenue requirements for the test years had included a for-profit transaction based on non-arms length inter-affiliate negotiations, rather than a flow-through of the cost of financing incurred by AUGI. CG provided the following Table to demonstrate what it considered to be a material impact of the proposed for-profit financing by AUGI. CG suggested that the proposed inter-affiliate profit element in AUI's debt cost, being the excess over AUGI's 2008 average rate of 4.1 percent, effectively increased AUI's return on equity from 8.75 percent to 11.608 percent and 12.041 percent, respectively, for 2008 and 2009. CG considered that use of 4.1 percent as a proxy for AUGI's 2009 interest rate was being conservative given the down trend in interest rates.

369. Consequently, CG submitted that AUI's proposed increases to actual and forecast AUGI interest rates are not warranted and provide AUI with effective rates of return on common equity that are not justified and are at the expense of rate payers. Therefore, CG further submitted that AUI should be directed to calculate the cost of debt on the basis of interest rates of 4.1 percent for each of the test years.

370. However, CG noted that AUI's 2005 debt had previously been approved by the Board with a deemed interest rate of 5.44 percent. If this existing AUI 2005 debt should be incorporated into the test year considerations, CG acknowledged that some modification to its proposal would be required. Allowing consideration of the 2005 debenture rate, CG estimated debt costs to amount to approximately $3.460 million and $3.534 million, respectively, in 2008 and 2009 as set out in the following Table.

195 Ex. 114, RBC Royal Bank Letter dated March 26, 2009 (Undertaking; Tr. Vol. 2, p. 293, l. 15).

Table 18. Impact of Inter-affiliate for Profit Debt Financing from AUGI

		[AUI] Reference Schedule	2008 Forecast	2009 Forecast
1	Return on Equity	2.2	8,228,834	9,524,849
2	Mid-Year Rate Base Net CIAC	2.3	114,629,552	129,487,070
3	Debt Capital	2.8	67,631,436	76,397,371
4	Equity Capital	2.8	46,998,117	53,089,699
5	Total		114,629,552	129,487,070
6	Debt components:			
7	2003 Debt		15,000,000	
8	2005 Debt		30,000,000	30,000,000
9	Short term		22,631,436	46,397,371
			67,631,436	76,397,371
10	Debt costs:			
11	2003 Debt @ 6.0%		900,000	
12	2005 Debt @ 5.44%		1,632,000	1,632,000
13	Short term @ 4.1%		927,889	1,902,292
14	Total Debt cost		3,459,889	3,534,292
15	Equity cost	2.8	4,112,335	4,645,349
16	Return on Equity		7,572,224	8,179,641

Source: CG Argument, p. 85.

371. CG disagreed that the stand alone concept for debt cost has been accepted for AUI for regulatory purposes. For purposes of addressing an interest rate for AUI's 2005 debenture CG submitted that the Board was constrained from using a mirrored-down approach due to prevailing unique circumstances, including the acquisition of AUI by AUGI (the 2005 Transaction), by AUGI not being a rated entity and by a rate for AUGI not be provided in the record. CG submitted that, as the present proceeding includes a detailed record of AUGI's debt costs and the parameters of the source of AUI funding, the mirror down approach to determine AUI's debt costs was the most appropriate.

372. CG also disagreed with AUI's position that the short-term borrowing agreements between AUI and AUHI relate to "for profit" affiliate services and the debt agreements are "Services Agreements" within the meaning of AUI's Code of Conduct, which require a determination of fair market value. CG stated that "Services Agreements" between affiliates can be either shared services or for profit services and that AUI failed to provide adequate support to justify classifying the debt agreements as for profit services. Consequently, CG submitted that the debt agreements should be classified as shared services, consistent with the affiliate overhead costs, and result in a flow-through of AUGI debt costs to AUI.

373. CG dismissed the letter from the RBC,[196] which AUI filed in support of its proposed debt rates, as not providing any detailed analysis of, or support for, the rates. CG noted that AUI did

196 Ex. 114, RBC Royal Bank Letter dated March 26, 2009 (Undertaking; Tr. Vol. 2, p. 293, l. 15).

not provide an RBC witness to speak to the rates set out in the letter and that the RBC declined to provide the *curriculum vitae* of the letter's author.

374. UCA agreed with CG and questioned the objectivity of the letter from the RBC as support for AUI's proposed interest costs. UCA noted that the RBC appears to be one of the lenders and lead banker for the AltaGas group of companies and that, as the letter's author was not made available for cross-examination and his *curriculum vitae* was not provided, his qualifications to be able to speak to the rates concerned are unknown.

375. UCA noted that AUI proposed to include a mark-up on its short-term debt with AUHI and opined that since the 2005 Transaction AUI had become a profit centre for AUGI. UCA objected to the mark-ups and considered that financing costs imposed by AUHI, through AUGI, were examples of AUI being required to pay unnecessary and excessive costs. UCA also noted that reference to the mark-up or the method by which it has been calculated is not contained in AUI's the Application. UCA further noted that the ATCO utilities are able to obtain financing at a mirrored-down rate, without mark-or or lending-related fees, obtained by their parent in the market.

376. UCA noted that AUI was seeking approval for its actual contracted debt cost for 2008 of 5.820 percent for its demand note and 6.820 percent for its bridge financing (Table 17). UCA objected to the interest rates on those debt costs as being excessive.

377. UCA noted from AUGI's 2008 Annual Report that the sources of funding for AUGI's short-term and long-term loans to AUI are currently by way of bankers' acceptances, which are less costly than prime rate loans. UCA further noted from cross-examination that AUGI will continue to borrow at banker's acceptance rates through November 2010 for what is essentially all of its long-term debt at an effective rate that will probably be in the 2 percent to 3 percent range.[197] Consequently, based on AUGI's cost of debt, UCA calculated that the mark-up on AUI's cost of debt would be in excess of $1 million in 2008 and $3 million in 2009.

378. UCA disagreed with AUI that short-term borrowing arrangements between AUI and AUHI should be on a "for profit" affiliate services basis but instead should be a shared service under which debt costs are subject to a cost recovery basis. UCA argued that AUI operates within a cost-of-service jurisdiction and that its costs are entitled to be carefully scrutinized to ensure that they are necessary and reasonably or prudently incurred, particularly when the services are provided by a non-arms length affiliate. UCA submitted that this principle is the foundation and basis for AUI's Code of Conduct and that AUI provided no any credible evidence to support the interest rates which it agreed to pay to AUHI. Additionally, UCA argued that, while AUI stated that its cost of borrowings from AUHI reflect market rates, AUI did it provide any credible evidence to indicate what its stand alone cost of debt would be in the marketplace in either 2008 or 2009. UCA submitted that as AUI operates in a cost-of-service jurisdiction it should not be required to pay amounts to its affiliate which are not cost based.

379. UCA disagreed with AUI's position that the Board in Decision 2006-049 accepted the stand alone concept, which AUI purports to mean that its borrowing rate should be equal to that available in the marketplace. In reference to AUI's 2005 debenture issue UCA stated that AUI neglected to mention that its parent at the time (referred to as AIT), was borrowing at short-term rates but the loan to AUI was a long-term debenture with a five-year term. UCA submitted that

[197] Tr. Vol. 3, p. 391, ll. 24-25.

AIT had assumed a risk, which justified payment of a risk premium for which the Board allowed 150 basis points above the risk-free rate (Bank of Canada five-year bond). UCA considered this distinction was important in that AUI is using short-term debt in 2008 and 2009. UCA also submitted that even on a stand alone basis the rate available to AUI would not differ materially from bankers' acceptance rates available to AUHI in 2008 and 2009. UCA suggested that in the Commission's Generic Cost of Capital Proceeding[198] witnesses for AUI confirmed that AUI's short-term borrowings would be the same as those for AUGI.

380. UCA compared interest rates proposed by AUI with similar rates incurred by Pacific Northern Gas Ltd., a utility operating in British Columbia whose rate base was similar in size to AUI's, and AltaLink Management Ltd., an electric utility regulated by the Commission. UCA suggested that the rates incurred by these companies would be 3.35 percent and 3.1 percent, respectively.

381. UCA suggested that AUI has been precluded from looking at alternative financing sources which may be less costly by entering directly into the market or considering alternatives not mandated or recommended by AUGI. UCA opined that because of the significant revenues flowing to AUHI and AUGI, in the form of mark-ups, fees and shared costs, there is no incentive to change. UCA considered that the lending arrangements between the companies in the present corporate structure appear to be overly costly and provide little, if any, identifiable benefit to AUI. UCA also considered that the lending arrangements for both 2008 and 2009 were not prudent.

382. UCA noted that the interest rate on each of the AUHI loans to AUI is not fixed and varies automatically with each change in the Prime Rate. UCA argued that this situation not only confirms the short-term nature of these loans but it also gives rise to a question as to what rate is actually being applied for by AUI, the rate of 7 percent for both 2008 and 2009 in the Application, which is described as a "placeholder" or the rates inherent in the lending arrangements with AUHI effective May 1, 2008 and May 1, 2009. Notwithstanding, UCA, based on the understanding that AUI will not be obtaining long-term financing in 2009 and not likely until the current revolving bridge loan facility expires in May 2010, submitted that AUI's short-term borrowing rates from AUHI should be no greater than AUGI's cost of obtaining the funds which UCA understood to be the bankers acceptance rates. UCA also submitted that there was no meaningful evidence presented in the proceeding that would suggest that there was any material, if any, difference in risk between AUGI and AUI. Consequently, UCA recommended a borrowing rate for AUI of 4.1 percent in 2008 and, based on a range of 2 percent to 3 percent for bankers' acceptance rates forecast by AUI,[199] 2.5 percent in 2009, which would result in a reduction in AUI's revenue requirement of approximately $896,000 in 2008 and $2.088 million in 2009.

Views of the Commission

383. The Commission does not agree with AUI's position that, for purposes of determining AUI's debt costs, the stand alone principle has been accepted for regulatory purposes or that this principle was applied to AUI's debt cost which was the subject of Decision 2006-049. The Commission considers that the Board, in arriving at its conclusion for a rate of 5.44 percent for AUI's debenture issue in that decision, endorsed neither the stand alone principle nor the

[198] ID 85.
[199] Tr. Vol. 3, p. 391.

mirrored-down approach but instead was responding to the changed circumstances that resulted from the 2005 Transaction.

384. The Commission notes that in Decision 2006-049 the Board made the following comments concerning both of the aforementioned approaches:

> … the Board is of the view that [the mirroring down approach] would generally be acceptable when the utility could not borrow at a lower cost on its own and when neither the regulated utility nor a non-regulated parent incurs significant costs or obligations arising from the transaction that would contravene cross-subsidization parameters within AUI's Inter-Affiliate Code of Conduct. The "mirroring down" approach involves reflecting (in the operating utility) the actual percentage costs of debt to the financing entity and assigning to the particular operating utility those dollars of debt from an individual debt issuance by the financing entity. By mirroring down the debt from the parent to the utility, customers are protected from potentially cross-subsidizing debt costs between the two entities.
>
> …
>
> The Board notes that its position in Decision 2003-061 allows for the possibility of a parent utility charging a higher rate than its cost to the subsidiary utility in order to prevent a lower risk parent from subsidizing a higher risk utility subsidiary. However, in the Board's view this situation should only apply where the utility subsidiary has been shown to be clearly and materially more risky than the parent or if the applicant otherwise provided sufficient evidence that justified a higher rate.[200]

385. Further, the Commission is not persuaded by AUI that its short-term borrowing agreements with AUHI should represent "for profit" affiliate services. In reviewing AUI's Inter-affiliate Code of Conduct the Commission notes that section 4.1 states:

> Where a Utility determines it is prudent in operating its Utility business to do so, it may obtain For Profit Affiliate Services from and Affiliate or provide For Profit Affiliate Services to an Affiliate.

In this instance the Commission would question the prudence of using a for profit affiliate service. The Commission notes that AUI, based on the composite allocation factor used for inter-affiliate financial market service, comprises approximately 85 percent of AUGI's four investments in operating entities and that AUI is one of only two entities for which AUGI has operating responsibilities. This relative size of AUI would suggest to the Commission that any inherent borrowing risk attributed to AUI should not necessarily be viewed as being significantly more, if any, than that for AUGI. Moreover, the RBC evidence provided by AUI does not demonstrate to the Commission's satisfaction that any material difference in risk between AUI and AUGI clearly exists. Further, given the variance in rates between AUI's proposed cost of debt for 2008 and 2009 and the amounts indicated as actually incurred by AUGI, the Commission considers that AUI's proposed debt rates with AUHI would be tantamount to unreasonably subsidizing AUGI's debt costs. Therefore, the Commission does not accept AUI's proposed composite rates for its cost of debt for 2008 and 2009.

386. The Commission notes that CG recommended a cost of debt for AUI of 4.1 percent in 2008 and 2009, subject to modification with respect to the 5.44 percent approved for the 2005

[200] Decision 2006-049, p. 4.

debenture, and that UCA recommended rates of 4.1 percent and 2.5 percent in those years, respectively. The recommendations of CG and UCA were based on the mirrored down approach. The Commission concurs that this approach under the circumstances attributable to AUI's debt financing requirements in the test years is warranted.

387. The Commission notes that, with the exception of its 2005 debenture with an approved rate of 5.44 percent, the remainder of AUI's debt financing in 2008 and 2009 is on a short-term basis with AUHI. As AUHI obtains its financing from AUGI the Commission considers that the rates for debt incurred by AUGI should be applied to the debt of AUI. For 2008 AUGI's average debt rate was stated to be 4.1 percent and for 2009 the rate was stated to be in the range of 2 percent to 3 percent. Given that short-term rates of the type of debt being used by AUGI vary throughout the year the Commission will accept the upper range of 3 percent for 2009. Accordingly, for purposes of this Application the Commission directs AUI in the compliance filing to utilize a rate of 4.1 percent in 2008 and 3.0 percent in 2009 in respect of its debt arrangements with AUHI.

8.3 Carrying Costs on Deficiencies or Surpluses

388. In the Second Update AUI included a request for approval of carrying costs related to 2008-2009 deficiencies or surpluses. AUI proposed that for the calculation of carrying costs it would apply its weighted average cost of capital (WACC) to the difference between the revenue from the tolls charged by AUI in 2008 and 2009 and the revenue requirement that is ultimately determined for those years. AUI also proposed that carrying costs would be collected prospectively through a revenue deficiency rider effective from January 1, 2008.

389. AUI's WACC for 2008 was 7.178 percent, including a rate of 8.75 percent on 41 percent common equity in the capital structure. For 2009, the WACC will depend on the Commission's decision in the 2009 Generic Cost of Capital proceeding, where AUI has taken the position that a fair return would be 11 percent on a capital structure with 46 percent equity.

Views of AUI

390. AUI submitted that carrying costs should be allowed to protect against the impacts of regulatory lag to ensure that either the utility or the customer is not unduly burdened. AUI also submitted that carrying costs applied with a rate that reflects the actual cost of money will result in tolls that are just and reasonable, eliminate temporal subsidization, reflect the principle of cost-based tolls, and create equity as between the utility and its customers. AUI noted that regulatory lag could mean that its final rates may not be in place for 2008 until 2010.

391. AUI considered that the funding of deficiencies is part of its ongoing funding of its operations and that it cannot borrow funds, even short-term debt, without relying on its underlying equity to do so. Consequently, AUI submitted that the interest rate set out in the Commission's Rule 023 – *Rules Respecting Payment of Interest (formerly IL 2000-01)* (Rule 023), being the Bank of Canada Bank Rate plus 1.5 percent, does not reflect the actual carrying costs that it incurs. AUI stated that a utility does not realize its return on equity until the cash is collected, which is assumed in the regulatory model to be the revenue lag. Accordingly, AUI submitted that since revenue lag is included in determining cash working capital and rate base and since rate base is financed with debt and equity, an appropriate carrying cost rate should be WACC.

392. AUI added that a revenue deficiency had the same characteristics as a deferred cost since it will not be collected until some time after the test years. AUI submitted that, for regulatory purposes, it has been previously been approved to apply WACC to deferred items.

Views of the Interveners

393. CG submitted that AUI's request for carrying costs should not be allowed. In particular, CG was concerned with AUI's request for carrying costs on the forecast revenue deficiencies for the following reasons:

a) the regulatory lag primarily arises due to AUI's own actions in filing its application mid way through the first test period with an update in the fourth quarter and some recognition of potential regulatory delays should have reasonably been factored into the timing of its GRA filing;

b) the date of AUI's update filing is relevant to the consideration of regulatory lag, particularly in the instant case where the initial filing was deficient in terms of filing requirements, in which case, to the extent any regulatory lag is viewed as being caused by the AUI, then customers should not be responsible for any carrying costs;

c) the delay in the timing of the filing by AUI on February 23, 2009 for 2008 interim rates after its filing for 2009 interim rates on December 10, 2008 suggests customers should not be responsible for costs occasioned by such filing delays;

d) AUI's proposal to collect carrying costs for forecast revenue deficiencies commencing January 1, 2008 during 2010 was inconsistent given that the Application was not filed until the latter part of 2008;

e) the AUI model was too simplistic in calculating forecast deficiencies or excesses using a mid-year convention and, being done without a monthly calculation of forecast deficiencies/excesses by rate class, created the potential for cross-subsidization between rate classes and between seasonal and non-seasonal customers.

394. CG also submitted that application of the Commission's Rule 023, would preclude AUI from charging amounts for carrying costs because:

- AUI has been allowed to collect interim rates for both 2008[201] and 2009,[202] and
- given the dates of the AUI initial filing, two series of updates and consideration of motions with respect to deficiencies in the filings, calculating a regulatory lag that exceeds 12 months for this proceeding would be difficult.

CG noted that the WACC proposed to be used by AUI exceeds the rate set out in Rule 023.

395. UCA objected to the proposed carrying costs requested by AUI. UCA submitted that the Commission's Rule 023 should be the basis for determining the applicability of carrying costs.

[201] Decision 2009-038, AltaGas Utilities Inc., 2008 Interim Refundable Rates (Released: March 30, 2009).
[202] Decision 2009-024, AltaGas Utilities Inc., 2009 Interim Refundable Rates (Released: February 11, 2009).

Views of the Commission

396. The Commission considers that the guidelines set out in Rule 023 (formerly the Board's information letter IL 2000-1) are applicable to AUI's request for carrying costs in this instance. The Commission particularly notes section 3(2)(a) of Rule 023 which states

> (a) an adjustment from interim to final approved rates will normally be excluded from the awarding of interest since the interim rate is designed to reduce significant amounts that would otherwise be outstanding, except in situations where the adjustment resulted from significant errors or excesses on the part of the utility concerned or from circumstances that could not otherwise be contemplated when the rates in question were set;

The Commission has approved interim rates for AUI for each of 2008 (Decision 2009-038[203]) and 2009 (Decision 2009-024) amounting to 50 percent of deficiencies AUI had forecast for those years. As interim rates were awarded to provide compensation until final rates for AUI have been approved for the test years and as the Commission considers that there are no extenuating circumstances evident that would otherwise suggest exceptions to the aforementioned section in Rule 023 the Commission denies AUI's proposal to charge customers with carrying costs in respect of the 2008 and 2009 test years.

9 COMPLIANCE FILING

397. The Commission directs AUI to revise its 2008-2009 GRA Phase I to reflect the Commission's findings, conclusions and directions in this Decision and to make a compliance filing for its 2008-2009 GRA Phase I by January 8, 2010. The Commission expects AUI in its compliance filing to provide a summary of all adjustments made.

[203] Decision 2009-038: AltaGas Utilities Inc., 2008 Interim Refundable Rates (Application No. 1604826, Proceeding ID. 170) (Released: March 30, 2009).

10 ORDER

398. IT IS HEREBY ORDERED THAT:

(1) AltaGas Utilities Inc. shall comply with all Commission directions in this Decision.

(2) AltaGas Utilities Inc. shall make a compliance filing for its 2008-2009 GRA Phase I as required by this Decision, incorporating the findings, conclusions and directions in this Decision.

Dated in Calgary, Alberta on October 29, 2009.

ALBERTA UTILITIES COMMISSION

(original signed by)

N. Allen Maydonik, Q.C.
Panel Chair

(original signed by)

Tudor Beattie, Q.C.
Commissioner

(original signed by)

Mark Kolesar
Commissioner

APPENDIX 1 – PROCEEDING PARTICIPANTS

Name of Organization (Abbreviation) Counsel or Representative (APPLICANTS)
AltaGas Utilities Inc. (AUI or AltaGas) C. K. Yates, Q.C. D. P. Langen
Alberta Sugar Beet Growers / Potato Growers of Alberta (ASBG/PGA) J. H. Unryn
Consumers' Coalition of Alberta J. A. Wachowich
Public Institutional Consumers of Alberta (PICA) N. J. McKenzie
Office of the Utilities Consumer Advocate (UCA) J. A. Bryan, Q.C.

Alberta Utilities Commission

Commission Panel
N. A. Maydonik, Q.C., Panel Chair
T. Beattie, Q.C., Commissioner
M. Kolesar, Commissioner

Commission Staff
V. A. Slawinski (Commission Counsel)
C. Burt
J. R. Clarke
M. McJannet
D. R. Weir, CA

APPENDIX 2 – ORAL HEARING – REGISTERED APPEARANCES

Name of Organization (Abbreviation) Counsel or Representative (APPLICANTS)	Witnesses
AltaGas Utilities Inc. (AUI or AltaGas) C. Yates, Q.C.	Part 1 A. Emmerzael G. Johnston E. Tuele A. Mantei H. Stribrny R. Koizumi Part 2 A. Mantei E. Tuele J. Green R. Hillman
Alberta Sugar Beet Growers / Potato Growers of Alberta H. Unryn	
Consumers' Coalition of Alberta J. Wachowich N. McKenzie	Part 1 A. Merani
Office of the Utilities Consumer Advocate (UCA) J. Bryan, Q.C.	Part 1 R. Bruggeman Part 2 R. Bruggeman R. Popik

APPENDIX 3 – SUMMARY OF COMMISSION DIRECTIONS

This section is provided for the convenience of readers. In the event of any difference between the Directions in this section and those in the main body of the Decision, the wording in the main body of the Decision shall prevail.

1. The Commission is of the view that the best information available with respect to 2009 opening balances for PP&E is the actual closing balances for 2008. On this basis, the Commission considers that AUI should update its 2009 opening balance for PP&E. Therefore the Commission directs AUI in the compliance filing to update its 2009 opening balances for PP&E to include the actual closing balance amounts filed for 2008. .... Paragraph 24

2. Noting previous rulings with respect to contractor inflation, and the agreement between UCA and AUI, the Commission considers that a contractor inflation rate of 5 percent for capital expenditures is reasonable. Therefore, the Commission directs AUI in the compliance filing to apply a 5 percent inflation rate for contractor costs to arrive at the 2009 forecast capital expenditures. .... Paragraph 27

3. With respect to unit costs for 2009, given that the Commission has accepted a capital inflation rate of 5 percent for 2009, as noted previously in this Decision, the Commission considers that this inflation rate should be applied to unit costs for 2009. Therefore the Commission directs AUI in the compliance filing to adjust the 2009 unit costs for material and labour associated with system betterment so that the Schedule shown in UCA-AUI-7(b)(ii) shows a Change in Total Cost (%) of 5 percent instead of 7 percent, 6 percent, and 7 percent, respectively, for Rural-Other, Rural Subdivision, and Town. .... Paragraph 41

4. The Commission notes that, with respect to 2009, UCA has recommended that the inspection component be set at $1,188,000 based on an inflation rate of 5 percent and the addition of one FTE at $75,000. The Commission notes that if the 2009 forecast is reduced by $75,000 to $1,428,100, an implied inflation rate of approximately 11 percent is required to inflate the 2008 forecast of $1,277,400 to $1,428,100. The Commission considers that this implied inflation rate is too high. UCA has recommended the use of a 5 percent inflation rate. Given that the Commission has previously accepted a 5 percent inflation rate for capital expenditures, the Commission considers that a 5 percent inflation rate should be used to inflate the inspection component. Applying the 5 percent inflation rate to the 2008 forecast of $1,277,400 and adding the additional FTE results in a 2009 forecast of $1,416,270, which the Commission considers to be a reasonable amount for inspection costs in 2009. Therefore, the Commission directs AUI in the compliance filing to reduce its 2009 forecast inspection costs from $1,503,100 to $1,416,270. .... Paragraph 43

5. With respect to the system betterment costs for 2008, the Commission notes the significant difference between the 2008 forecast and 2008 actual results for system betterment costs and the UCA's recommendation for a reduction of $479,000. The Commission agrees with UCA's recommendations in this regard. Therefore the Commission directs AUI in the compliance filing to reduce the 2008 forecast by the known cancellations and deferrals of $479,000 and to further reduce the 2008 forecast by

the unidentified projects that were cancelled or did not occur, and to provide appropriate schedules in the compliance filing so the Commission and interveners can examine the adjustments. .... Paragraph 52

6. While AUI has provided information with respect to the need for its forecast system betterment projects for 2009, the Commission is not convinced that AUI will be able to complete the forecast volume of work in 2009, based on historical system betterment costs. For these reasons, the Commission will reduce the 2009 forecast. Therefore the Commission directs AUI in the compliance filing to reduce its 2009 system betterment costs to $4,375,000. .... Paragraph 55

7. The Commission is satisfied that AUI’s Second Update properly moved the costs of the Beaumont High Pressure Gas Supply project into CWIP at year-end 2008 and removed costs that were originally included in AUI’s 2009 forecast. The Commission directs AUI in the compliance filing to confirm that it has updated its schedules to reflect the changes referenced above, in particular with regards to any impact that arises to rate base, depreciation expense, CWIP, and allowance for funds used during construction (AFUDC). .... Paragraph 61

8. The Commission considers that it would be reasonable to reduce the 2008 capital additions by $51,200 as recommended by UCA and agreed to by AUI, to take advantage of the new information now available. Therefore, the Commission directs AUI in the compliance filing to reduce 2008 capital additions by $51,200. .... Paragraph 64

9. The Commission agrees with AUI that $17,700 and $12,400 should be removed from the 2008 forecast for system betterment associated with the Red Earth Loopline and Relocate SE033 projects respectively. Therefore the Commission directs AUI in its compliance filing to make these adjustments. .... Paragraph 67

10. The Commission agrees with UCA that the border station forecast of $487,000 should be reduced by $104,000 to $383,000. Therefore the Commission directs AUI in the compliance filing to reduce the 2009 forecast for border stations to $383,000. .... Paragraph 75

11. The Commission notes that AUI has indicated that it will address CG’s concern with respect to transparency of the purchasing burden. The Commission finds this proposal to be helpful, and directs AUI in the compliance filing to include this reconciliation. Further, the Commission directs AUI in the compliance filing to outline any offsets that are applicable to operation expenses. .... Paragraph 107

12. With respect to AUI’s proposed 2009 contractor labour rate, the Commission is reluctant to move to the range suggested by CG considering that CG’s recommendation was based on a market update dated March 20, 2009, and may not be representative for the entire year. The Commission finds a 5 percent composite escalation rate for contractors, the mid-point of AUI’s estimate, to be reasonable. Further, the Commission has previously approved a 5 percent inflation rate for capital inflation, which adds further support to the Commission’s view that 5 percent is reasonable. Therefore, on this basis the Commission directs AUI, in its compliance filing, to use a 5 percent direct contractor escalation rate in its 2009 revenue requirement. .... Paragraph 121

13. The Commission notes that the actual 2008 average hiring date for new hires was September 2008 and also notes that this date was close to the average mid-July start date for new hires over the period 2005 through 2007. Noting that only two of the proposed

fifteen positions had been filled by AUI on April 1, 2009, the Commission finds the proposed start date of July 1, 2009 to be more reasonable than AUI's April 1, 2009 start date. Therefore, the Commission directs AUI, in its compliance filing, to use the July 1 start date for its forecast of new hires. .... Paragraph 135

14. The Commission finds the use of historical average frictional vacancy rates as a reasonable predictor of FTE vacancy rates for the test period. Therefore, the Commission directs AUI, in its compliance filing, to incorporate a 3.7 percent frictional rate in its revenue requirement, resulting in a frictional vacancy rate of 6.8 and 7.4 FTEs in 2008 and 2009 respectively. .... Paragraph 140

15. In consideration of the above, the Commission finds that AUI has not complied with the direction from Decision 2007-094. Further, with respect to Decision 2007-094, the Board determined the specific STIP amounts for each employee group. The granting of a deferral account by the Board does not preclude the specifics of payout within each group. Therefore, the Commission directs AUI in its compliance filing to ensure that $38,100 has been accrued in the deferral account. To be clear, only $109,300 should have been paid out in 2007 in respect of Executive STIP. .... Paragraph 164

16. Considering the above, in order that any future STIP amounts can be clearly understood and assessed, the Commission directs AUI, in its next GRA to provide details regarding its STIP forecast for each group of employees that are eligible for this incentive. Further, the Commission directs AUI to also include the following details as noted in Decision 2007-094:

> The explanation and details provided are to include, but not be limited to, clear and measurable targets in each key result area, the method by which AUI calculates its forecast STIP amount, and the results that AUI expects in terms of shareholder and customer value.

.... Paragraph 167

17. The Commission notes agreement between the parties in respect of UCA's proposed reduction to the 2009 amortization of CEO/CFO Certification Costs. Therefore the Commission directs AUI, in its compliance filing to reduce its 2009 amortization of deferred CEO/CFO Certification Costs from $340,000 to $314,000. .... Paragraph 176

18. For the reasons noted above, the Commission finds AUI's proposal to reduce 2009 forecast vehicle expenses by $52,300 to be reasonable. Therefore the Commission directs AUI in its compliance to reduce forecast vehicle expenses by $52,300 for 2009. .... Paragraph 182

19. Therefore, the Commission directs AUI in its next GRA to examine the options of obtaining proper indemnification from third-party suppliers and to provide a cost/benefit analysis of expanding its insurance coverage to include events such as restoration of service following a third-party gas supplier's system failure. The assessment should include but not be limited to:
   a. the number of third party gas suppliers on AUI's system;
   b. the number of such occurrences in the last 15 years where a third-party's gas supply system has failed;
   c. a breakdown of costs actually incurred to repair and remediate service to customers;
   d. details respecting any direct or indirect costs incurred by customers due to loss of service; and
   e. subsequent recoveries (if any) from the gas supplier(s). .... Paragraph 207

20. The Commission finds that the actual costs associated with the restoration of service to customers in the Athabasca area in 2008 were prudently incurred in the provision of utility service and properly belong in AUI's 2008 revenue requirement. Therefore, the Commission rejects CG's recommendation to disallow recovery of the $100,000 Athabasca loss until such time that AUI has exhausted its appropriate legal recourse. However, the Commission directs AUI, at its next GRA, to include details of the outcome of its attempt to get compensation from the third-party which caused the damage. .... Paragraph 208

21. However, the Commission directs AUI in its next GRA to provide details of the actual costs incurred for looping the Pincher Creek transmission line. .... Paragraph 214

22. The Commission finds AUI's leak survey forecast to be high. The Commission considers CG's recommendation that AUI's test year leak survey forecast be based on AUI's total actual leak survey costs ($191,000) incurred in 2007 indexed for an escalation factor to be a more reasonable estimate of the costs. Additionally, the Commission finds its approved 5.0 percent direct capital contractor escalation rate in Section 4.1, to be applicable. Accordingly, the Commission directs AUI, in its compliance filing, to reduce its leak survey forecast by $49,950 in 2008 and $89,723 in 2009. .... Paragraph 220

23. Similar to AUGI's Supplemental Employee Retirement Plan (SERP) discussed in Section 5.1.1, the Commission considers that this amount would ordinarily be for the account of shareholders as payment would be at the discretion of AUI's Board of Directors as it relates to previous employment of an officer in another company. Therefore, the Commission considers that AUI has not demonstrated to the Commission's satisfaction that the inclusion of this amount should be included in revenue requirement and denies AUI's request. Therefore, the Commission directs AUI in its compliance filing to remove the $5,000 amount in each of the test years from its revenue requirement. .... Paragraph 230

24. The Commission acknowledges AUI's agreement with CG's recommendation. Accordingly, the Commission directs AUI in its compliance filing to reduce its revenue requirement by $30,000 in 2009, which arises out of a 2009 Gas Utilities Act Audit exemption that AUI obtained from the Commission. .... Paragraph 249

25. The Commission agrees with CG's submission that AUC Rule 026 should provide greater certainty and clarity as far as regulatory compliance requirements related to IFRS. Accordingly, the Commission directs AUI in its compliance filing to specify and explain in detail the amount of its total forecast IFRS costs and to demonstrate that there is no duplication of amounts that are included in its inter-affiliate shared services charges. .... Paragraph 255

26. The Commission finds that there is no compelling evidence presented by any party that would suggest that the Commission should deviate from the Board's position in Decision 2007 094 wherein the Board considered that the charges were excessive. Therefore, for the 2008 and 2009 test years, the Commission considers that a reduction in AUI's forecasts of inter-affiliate shared service charges, exclusive of amounts for STIP or SERP, is warranted. To calculate the reduction, the Commission directs AUI in the compliance filing to reduce its forecast of charges for inter-affiliate shared services to the level that represents the average percentage of AUGI's total costs that were allowed before the STIP charge in 2007. Based on Attachment 1, page 1 of 3 of Exhibit 75, the Commission has determined this average percentage to be 56.78 percent. The

Commission directs AUI in the compliance filing to include in its revenue requirement only 56.78 percent of AUGI's operation service and financial market service costs forecast for 2008 and 2009 as inter-affiliate shared service costs for AUI. .... Paragraph 321

27. The Commission finds that the mid year difference of $170,650 is a reasonable proxy for the insurance savings arising from the 2005 Transaction. This amount calculated as a proportion of the mid-year insurance expense prior to the 2005 Transaction provides an effective benefit of approximately 23 percent. For purposes of this Decision, the Commission considers that this benefit should be applied to adjust AUI's 2008 and 2009 forecast insurance costs. The Commission finds that 23 percent of AUI's forecast 2008 and 2009 insurance expense should be added to revenue requirement to give effect to this benefit and directs AUI in the compliance filing to make this adjustment.... Paragraph 325

28. With respect to SERP entitlements proposed to be included in charges for inter-affiliate services, the Commission is of the view that any consideration for years of service at a previous organization given to an employee in an executive position in AUGI would be at the discretion of the directors of AUGI and therefore should not be borne by customers of AUI. Therefore, similar to shareholder related STIP costs, the Commission considers that SERP costs should be excluded from inter-affiliated shared service costs allocated to AUI by AUGI. The Commission therefore directs AUI to exclude any SERP expense in each of 2008 and 2009 from amounts of inter-affiliate shared services to be included in revenue requirement. .... Paragraph 327

29. The Commission is aware that AUI will be paying ongoing fees to AUGI for management or other services rendered. The actual amount of those fees that are paid to AUGI on an annual basis is ordinarily not subject to the Commission's determination, unless those fees were to affect the viability of AUI's utility services. However, it is the duty of the Commission to review and assess the reasonableness of the amounts of any such inter-affiliate charges that AUI proposes to be included in its rates. Therefore, because the magnitude of the inter-affiliate shared service fees to be included in AUI's revenue requirement is clearly an ongoing issue the Commission directs AUI, for purposes of its next GRA to provide:

- detailed analyses of the time, charges and description of the services provided for each of the specific operational and financial market services to be rendered by each of the AUGI employees;
- specific details of third party costs incurred by AUGI, which AUI proposes to include in its forecast of revenue requirement for the costs for those services;
- a detailed explanation of the cost drivers of any increases for each specific operational and/or financial market service;
- a detailed explanation of the allocation of CEO and CFO costs between operational and financial market service
- identification of any changes to the methodology of allocating inter-affiliate costs compared to previous applications; and
- an evaluation of the reasonableness of the inter-affiliate costs as per each individual service instead of a conclusion based on a basket of services approach. ..... Paragraph 328

30. The Commission also notes that AUI asserted that the significance of using the "cost recovery basis" as a standard for pricing of shared services is that "market value" is not the requisite test either for individual services or for all services in the aggregate. AUI

added that the test for the use by a utility of an affiliate service is prudence, as identified in its Code. Although the Commission agrees that the test for shared services is that the costs incurred are shown to be prudent, FMV may be utilized in the Commission's evaluations of whether or not a utility acted prudently. The Commission notes that section 3.3.4 of AUI's Code provides that AUI must periodically review the prudence of continuing shared services arrangements with a view to making any necessary adjustments to ensure that each of AUI and its affiliates bears its proportionate share of costs. AUI is therefore directed to in the compliance filing to explain why, for the purposes of inclusion in AUI's revenue requirement, receiving services from an affiliate is prudent especially wherein the costs of that service may be above FMV. .... Paragraph 329

31. The Commission notes that no party took issue with AUI's forecasts of inter-affiliate charges for profit and thus will accept AUI's forecasts. The Commission also notes that AUI's Inter-affiliate Code of Conduct states:

> When a Utility acquires For Profit Affiliate Services, it shall pay no more than the Fair Market Value of such services. The onus is on the Utility to demonstrate that the For Profit Affiliate Services have been acquired at a price that is no more than the Fair Market Value of such Services.

For purposes of AUI's next GRA, Phase I, the Commission directs AUI to demonstrate that any inter-affiliate charges for profit included in its forecasts have been priced at FMV. .... Paragraph 332

32. The Commission notes that AUI did not maximize the use of CCA in its 2009 forecast of income taxes, which would have had the effect of creating a non-capital loss that could have been applied to reduce the 2008 income tax expense. Unless otherwise approved by the Commission, the use of the flow-through method to determine income taxes mandates that all available deductions that would be allowed under income tax laws are to be claimed in order to minimize the income tax component included in revenue requirement. Therefore, the Commission directs AUI in its compliance filing to minimize its income tax expense forecast in 2008 and 2009 in accordance with the Federal and Alberta income tax laws that have been enacted, or that may be viewed as being substantially enacted, for those years. .... Paragraph 346

33. Notwithstanding these views, the Commission considers that in the future there may be merit in establishing a deferral account to reconcile variances that may arise in dealing with expenditures that are capitalized for regulatory purposes but deducted for income tax purposes in the year incurred. On this basis the Commission directs AUI in the compliance filing to comment on the suitability of such a deferral account as it may apply to AUI. .... Paragraph 348

34. The Commission notes that depreciation and amortization expense was not raised as an issue by any party. However, the Commission also notes that depreciation and amortization expense forecast by AUI for 2008 and 2009 would be subject to any changes made to forecasts affecting rate base. Therefore, the Commission directs AUI in its compliance filing to adjust depreciation and amortization expense accordingly to reflect changes to forecast capital expenditures in 2008 and 2009 as directed in this Decision. .... Paragraph 350

35. The Commission notes that, with the exception of its 2005 debenture with an approved rate of 5.44 percent, the remainder of AUI's debt financing in 2008 and 2009 is on a

short-term basis with AUHI. As AUHI obtains its financing from AUGI the Commission considers that the rates for debt incurred by AUGI should be applied to the debt of AUI. For 2008 AUGI's average debt rate was stated to be 4.1 percent and for 2009 the rate was stated to be in the range of 2 percent to 3 percent. Given that short-term rates of the type of debt being used by AUGI vary throughout the year the Commission will accept the upper range of 3 percent for 2009. Accordingly, for purposes of this Application the Commission directs AUI in the compliance filing to utilize a rate of 4.1 percent in 2008 and 3.0 percent in 2009 in respect of its debt arrangements with AUHI. ..... Paragraph 387

36. The Commission directs AUI to revise its 2008-2009 GRA Phase I to reflect the Commission's findings, conclusions and directions in this Decision and to make a compliance filing for its 2008-2009 GRA Phase I by January 8, 2010. The Commission expects AUI in its compliance filing to provide a summary of all adjustments made. .... Paragraph 397