



AltaGas Utilities Inc.

2007 General Rate Application Phase I

December 11, 2007

ALBERTA ENERGY AND UTILITIES BOARD

Decision 2007-094: AltaGas Utilities Inc.
2007 General Rate Application Phase I
Application No. 1494406

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Calgary Alberta

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1 INTRODUCTION

AltaGas Utilities Inc. (AUI) filed a 2007 General Rate Application (GRA) Phase I (the Application), dated December 29, 2006, with the Alberta Energy and Utilities Board (EUB or Board). The Application, filed under the provisions of the *Gas Utilities Act*¹ (GUA):

1. requested the Board's approval of AUI's revenue requirement and rate base required to serve customers in a safe, reliable and efficient manner, and
2. responded to outstanding Board Directions arising out of Decision 2005-127.²

AUI updated the Application on April 27, 2007 (2007 Forecast Update) to include actual 2006 results and known changes for 2007 that had occurred since the original filing date.³ For the 2007 test year, AUI forecasted a revenue requirement of approximately \$37.6 million.⁴ Further, under existing 2006 approved rates, AUI projected a 2007 revenue deficiency of \$3,974,000. AUI indicated that the main factors that had changed from the amounts allowed by the Board in 2006 were as follows:

Table 1. Revenue Deficiency Reconciliation

	2007 Forecast
Change from 2006 Allowed Revenue Requirement	
OM&A	\$3,918,800
Depreciation	568,400
Amortization of CIAC (Contributions in Aid of Construction)	4,400
Municipal Taxes	8,400
Income Taxes	(304,200)
Proposed Return on Rate Base	339,600
	4,535,400
Plus:	
2006 Deficiency	340,700
	4,876,100
Less:	
Change in Gross Margin	1,048,700
Other Revenue	(146,600)
Revenue Deficiency	\$3,974,000

¹ *Gas Utilities Act*, c. G-5, RSA 2000

² Decision 2005-127 – AltaGas Utilities Inc. 2005 – 2006 General Rate Application – Phase I (Application 1378000) (Released: November 29, 2005)

³ Exhibits 002-06, 002-06-01, 002-06-02 and 002-06-03

⁴ Because gas costs are a pass-through cost, it is customary to describe revenue requirement as net of gas costs. AUI's 2007 forecast gas costs are \$102,761,546.

The Board issued a notice of application (Notice) electronically to interested parties on AUI's 2005-2006 GRA Phase I distribution list on January 9, 2007 and published the Notice in major Alberta newspapers on January 11, 2007.

By letter dated February 13, 2007, the Board established a process schedule to deal with the Application.

At the request of AUI and interveners, the hearing was scheduled to commence in August, 2007.⁵ The Board conducted a public hearing in Edmonton from August 8, 2007 to August 10, 2007.

The panel assigned to preside at the oral hearing consisted of Mr. R.G. Lock, P.Eng. (Presiding Member), Ms. C. Dahl Rees, LL.B. (Member), and Mr. M.W. Edwards (Acting Member). Subsequent to the close of the hearing Mr. R.G. Lock retired from the Board.⁶ The Board set dates of September 12, 2007 and September 26, 2007, respectively, for argument and reply argument. Accordingly, for the purposes of this Decision, the Board considers the record to have closed on September 26, 2007.

In reaching the determinations contained within this Decision, the Board 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 Board's reasoning relating to a particular matter and should not be taken as an indication that the Board did not consider other relevant portions of the record with respect to that matter.

Subsections 36(a) and 40(a) of the GUA and section 91(1)(a) of the *Public Utilities Board Act*⁷ section 5 of the *Default Gas Supply Regulation*, and section 4(3) of the *Roles, Relationships and Responsibilities (RRR) Regulation*⁸ provide the Board with the power to assess just and reasonable rates and to consider all revenues and costs that are in the Board's opinion applicable. Section 44 of the GUA requires prior Board approval of any changes in existing rates, tolls or charges. The Board considers that in order to satisfy the burden of proof of showing that proposed increases in rates, tolls or charges are reasonable, satisfactory evidence must be presented justifying the cost items which comprise those rates.

2 BACKGROUND

By Decisions [2006-034](#),⁹ dated April 4, 2006, and Decision [2006-117](#),¹⁰ dated November 21, 2006, the Board approved AUI's first and second compliance filings, respectively, for its 2005-

⁵ Exhibits 002-03, 002-04

⁶ Subsection 10(2) of the *Alberta Energy and Utilities Board Act*, c. A-17 and subsection 5(2) of the *Public Utilities Board Act*, R.S.A. 2000, c. P-45 provide that a majority, or two members, constitutes a quorum at any sitting of a division of the Board.

⁷ R.S.A. 2000, c. P-45

⁸ *Roles, Relationships and Responsibilities Regulation*, Alta. Reg. 186/2003, subsection 4(3)

⁹ Decision 2006-034 – AltaGas Utilities Inc. 2005/2006 General Rate Application – Phase I Compliance Filing (Application 1436063) (Released: April 4, 2006)

¹⁰ Decision 2006-117 – AltaGas Utilities Inc. 2005/2006 General Rate Application Phase I Second Compliance Filing and Errata (Application 1474463) (Released: November 21, 2006) (Errata Released: November 22, 2006)

2006 GRA Phase 1. The Board approved AUI's revenue requirement of \$134,610,495 (which included a cost of gas component of \$101,639,832) and \$131,723,158 (which included a cost of gas component of \$98,623,093) and rate base of \$144,506,299 and \$146,585,346 for the 2005 and 2006 test years, respectively.

By Decision [2006-049](#),¹¹ dated May 24, 2006, the Board approved AUI's debenture issue to AltaGas Utility Holdings Inc.¹² (AUHI) in the principal amount of \$30,000,000 and at a rate of 5.44%. By letter dated October 31, 2006, AUI filed an application with the Board (No. 1484954) requesting that Decision 2006-049 be reviewed and varied. The Board denied AUI's review request on July 31, 2007.¹³

By Decision [2007-079](#),¹⁴ dated October 16, 2007 the Board approved the rates as filed in AUI's 2005-2006 GRA Phase II, (Application 1491262).

3 RATE BASE

Throughout the proceeding, AUI provided numerous updates to the Application. As per Exhibit 002-06-02, AUI provided the following revised rate base forecast:

Table 2. AUI 2007 Revised Rate Base Forecast

	2005 Allowed Normal	2006 Allowed Normal	2005 Actual Normal	2006 Actual Normal	2007 Forecast Normal
GROSS PLANT IN SERVICE	\$				
Beginning of Year	230,731,034	240,195,058	229,419,692	239,290,229	249,197,458
End of Year	240,195,058	247,901,150	239,290,229	249,197,458	262,610,137
Mid-Year	235,463,046	244,048,104	234,354,961	244,243,844	255,903,798
Less: Disallowed Plant, Mid-Year	-	-	13,149	13,149	-
Mid-Year Balance	235,463,046	244,048,104	234,341,812	244,230,695	255,903,798
ACCUMULATED DEPRECIATION					
Beginning of Year	89,553,435	95,248,067	89,383,648	95,263,212	101,371,550
End of Year	95,248,067	102,446,750	95,263,213	101,371,550	107,558,300
Mid-Year Balance	92,400,751	98,847,409	92,323,431	98,317,381	104,464,925
Mid-Year Plant in Service	143,062,295	145,200,696	142,018,381	145,913,314	151,438,873
Add: Working Capital	1,444,004	1,384,651	1,427,424	2,085,874	2,895,279
Mid-Year Rate Base	144,506,299	146,585,347	143,445,805	147,999,188	154,334,152
Less: Mid-Year CIAC	50,415,345	49,390,152	51,018,949	50,647,895	49,751,606
Mid-Year Rate Base Net CIAC	94,090,955	97,195,195	92,426,856	97,351,293	104,582,545

¹¹ Decision 2006-049 – AltaGas Utilities Inc. Request for Approval of Debenture Issue (Application 1426643) (Released: May 24, 2006)

¹² AltaGas Utility Holdings Inc. is the parent of AUI.

¹³ Exhibit 002-17, AUI opening statement, page 4

¹⁴ Decision 2007-079 – AltaGas Utilities Inc. 2005/2006 General Rate Application Phase II (Application 1491262) (Released: October 16, 2007)

No parties objected to the opening balances of any line items (including gross plant in service, accumulated depreciation, working capital, contributions in aid of construction (CIAC), mid-year plant in service, and mid-year rate base net of CIAC) included in AUI's Rate Base Schedule 2.3. Upon review of the record for this proceeding, the Board is satisfied with AUI's explanations of any variances between the allowed forecast for the 2005 and 2006 test years and actual results. Therefore the Board approves AUI's opening rate base balances utilized in AUI's 2007 rate base forecast.

No parties objected to AUI's 2007 forecast CIAC and depreciation expense for 2007. Upon review, the Board considers AUI's forecast CIAC and its depreciation methodology and resulting expense is appropriate. Therefore the Board approves AUI's forecast depreciation expense and CIAC as filed. Given the various revisions and updates to the Application, the Board directs AUI in the Refiling, to provide updated schedules that reflect all revisions and Board findings.

After review of AUI's compliance filing, the Board will make a final determination on AUI's 2007 forecast rate base.

3.1 Capitalization

In response to a direction by the Board in Decision 2005-127,¹⁵ AUI provided in the Application a copy of its capitalization guideline that it used to determine capitalized amounts and allocation,¹⁶ and a description of the types of costs and expenses it capitalizes. AUI indicated that the overheads capitalized were as follows:

- i. Project overheads – which include all costs that are capitalized on the basis of a standard cost allocation to specific capital projects. These direct costs, by their nature, are directly allocated to the specific project they relate to.¹⁷
- ii. Capital overheads – which include a portion of company engineering, drafting, construction supervision and purchasing costs relating to capital projects¹⁸ and which also include a portion of administrative and general expenses (expenses capitalized).¹⁹ Capital overheads are totaled and allocated on a pro-rata project cost basis to each specific project.²⁰

AUI applied to capitalize a forecast amount of \$2,489,600 in capital overheads for 2007. This represented an increase of approximately \$600,000 over the 2006 allowed amount with the

¹⁵ Decision 2005-127, page 9 and 29

¹⁶ Exhibit 002-01, pages 43-45

¹⁷ Exhibit 002-001 page 38 – “Project Overheads” are “...all costs that are capitalized on the basis of a standard cost allocation to specific capital projects. Project overheads are a direct cost of construction. These costs include construction inspection and land related costs.”; and page. 41.

¹⁸ Exhibit 002-001 page 38 – “Capital Overheads” are “...all costs that are capitalized but not charged directly to a capital project. These costs include company engineering and drafting costs, construction supervision costs, purchasing costs and expenses capitalized”.

¹⁹ Exhibit 002-001 page 38 - “Expenses Capitalized” are “...that portion of administrative and general costs impacted by varying levels of capital expenditure, which is included in capital overheads on the basis of the Board-approved capitalization factor of 35%.”

²⁰ Exhibit 002-09, CCA-AUI-6

increase being attributable to the portion of expenses capitalized which were made up of inter-affiliate shared costs.²¹

AUI submitted that it had provided complete details, of its methodology used to determine its forecast capital overheads. AUI indicated that application of the 35% factor was revised in 2007 to address concerns raised in its 2005-2006 GRA with respect to the blanket application of the 35% factor to all employee benefit costs.²² Instead of capitalizing 35% of all benefit costs, AUI revised its capitalization methodology to capitalize benefit costs associated with those portions of salary costs that were being capitalized. This resulted in capitalized benefit costs that follow salaries. AUI submitted that this was consistent with generally accepted accounting practice and with the method used by other Alberta utilities to capitalize benefits.²³

Views of the Board

Section 37 of the GUA provides the Board with the power to determine a rate base for the property of the owner of the gas utility used or required to be used to provide service to the public within Alberta. Costs that are capitalized are recovered through rate base. AUI indicated that “capital overhead” costs are capitalized but not charged to a specific capital project.²⁴

The Board considers that AUI has provided satisfactory evidence regarding its capital overheads. Accordingly, the Board approves AUI’s capital overheads and project overhead items, subject to any findings in this Decision and revisions included in AUI’s compliance filing.

The Board considers that AUI’s 35% capitalization rate for administration expenses and its revision to link the capitalization of benefits with salary are reasonable. No party took exception with this issue. Therefore the Board approves AUI’s capitalization rate for administration expenses and the total amount capitalized, subject to any changes resulting from the Board findings in this decision.

3.2 Capitalization Guidelines

While AUI submitted its capitalization guidelines in section 3.2 of the Application, Consumers Coalition of Alberta (CCA) submitted that it appeared AUI was not seeking approval of these guidelines, nor did it appear AUI explicitly received approval of the same.²⁵ CCA argued that all policies and guidelines impacting the determination of revenue requirement should be explicitly approved by the Board. CCA submitted that requiring Board approval of a policy or guidelines respecting capitalization should be no different than the policies or guidelines respecting matters such as allowance for funds used during construction (AFUDC).

CCA also submitted that there were a number of deficiencies in AUI’s capitalization policy:

1. AUI had no minimum dollar threshold test below which items that meet the definition of capital assets must nevertheless be expensed, and that in order to reduce the “nuisance” factor associated with capitalizing minor expenses, AUI should be directed to propose

²¹ Exhibits 002-01 pages 42 and 214; and 002-09 CCA-AUI-7

²² Exhibits 002-01 page 214; and 002-09 CCA-AUI-7

²³ Exhibits 002-01 page 214; 002-09 CCA-AUI-3 and 5; and Transcript Volume 1, pages 117-118

²⁴ Exhibit 002-01, page 38

²⁵ Exhibit 002-09, Response CCA.AUI-8 (a) and 8 (b)

such a minimum dollar threshold (for example \$1,000).²⁶ CCA submitted once a capital work order is opened, the minimum dollar threshold amount need not apply as that work order would include all expenses related to it, with all expenses included in that work order being capitalized.

2. Any capitalization policy should explicitly state that capitalized expenses should be of a nature which will provide benefit over a period of more than one year. CCA noted that even AUI agreed “as a general rule, an expense that is capitalized pursuant to the capitalization guideline relates to an asset with a service life of more than one year.”²⁷ CCA submitted providing for such a criterion will ensure compliance with the Canadian Institute of Chartered Accountants handbook (CICA Handbook) and provide affected employees the appropriate direction.
3. Any capitalization policy or guideline should provide direction related to treatment of government grants and insurance proceeds.
4. Any capitalization guideline or policy should include practices with respect to the following:
 - Definition of “assets”, both tangible and intangible
 - AFUDC
 - Interest during construction (if different than AFUDC)
 - Overhead capitalized
 - Indirect costs
 - Person(s) responsible for determination of expense vs. capital question, where there is a “gray” area.

CCA recommended that AUI provide, at its next GRA, a detailed policy or guideline (consistent with those of other utilities) with respect to capitalization procedures for review by interested parties and the Board and approval of the Board.

AUI confirmed that its capitalization guideline was already consistent with the CICA Handbook.²⁸ Second, AUI submitted that including minimum dollar thresholds and line items in AUI’s capitalization guideline ensures compliance was unnecessary, as AUI undergoes an annual audit and quarterly reviews in which all of its financial records, including operating and capital expenditures which are scrutinized in accordance with generally accepted accounting principles (GAAP) and the CICA Handbook. Third, AUI indicated that it was nearing completion of its CEO/CFO certification process which would add another layer of control and scrutiny.²⁹ Unlike non-regulated corporate entities, AUI argued that forecast and actual capital and operating expenditures (at times on a line by line basis) were subject to additional scrutiny by the Board and interveners during the public GRA regulatory process.

AUI considered that establishing corporate policies and guidelines was a corporate governance matter and was not properly the purview of anyone other than the board of directors of a corporation or its delegates. To the extent that the Board has any ability to comment on such policies it was limited to its jurisdiction under the GUA, which was the setting of just and

²⁶ In fact, Exhibit 002-09, Response CCA.AUI-32 (a) suggests this may be part of AUI’s practice: “The increase in general office supplies is due to expensing of smaller office equipment such as chairs...”

²⁷ Exhibit 002-009, Response CCA.AUI-8 (e)

²⁸ Exhibit 002-09, CCA-AUI-8(h)

²⁹ AUI Argument, pages 28-30

reasonable rates based on the determination of the prudent cost of rate base used or required to be used in the provision of gas utility service.

Views of the Board

The Board is of the view that establishing a transparent capitalization policy falls within the Board's purview under the GUA with regard to setting just and reasonable rates. Clear capitalization policies mitigate the potential for double-counting of costs that are capitalized or expensed. Further, it ensures that appropriate rules are in place to guide the utility in determining whether or not particular costs may be capitalized and thereby form a portion of the rate base. Any capitalization policy is subject to some level of discretion, but should be founded on established principles and parameters.

The Board agrees with CCA that a more detailed review of AUI's capitalization guideline or policy is appropriate. Therefore the Board directs AUI in its next GRA to file a detailed capitalization policy that addresses the issues raised by CCA, and to provide a full explanation of the rationale underlying its proposed policy. The capitalization policy filed should reflect that capitalized expenses would provide benefit over a period of more than one year. To the extent that the principles underlying the CICA Handbook are applicable, the Board encourages AUI to comply with the CICA Handbook.

3.3 AFUDC Rate

CCA noted that AUI used an AFUDC rate that was higher than its weighted average cost of capital (WACC) as noted in the following table:

Table 3. AFUDC Rate Compared to WACC

Source	2005	2006	2007
		%	
AFUDC % per X09-011, CCA.AUI-3 (c) Revised Aug 10, 2007	7.860	7.000	6.860
Weighted Average Cost of Capital per X002-06-02, Schedule 2.8	4.873	4.628	4.651

CCA noted that AUI provided the following rationale for the use of the AFUDC rate:

- 7 Q. MR. WACHOWICH: When we look at the weighted average cost of capital
8 amounts of 4.651 in 2007 and we've shown where we got that
9 data from, I wanted to get a sense of if you can explain
10 where the implied AFUDC rate of 7.92 percent in 2007 comes
11 from, we would have expected something, if not identical,
12 very close to the 4.651 percent?
13 A. MR. MANTEI: Actually, in my updated filing
14 I did correct it to the 6.86 percent which is the weighted
15 average cost to capital.
16 What you're doing, Mr. Wachowich, is you are
17 assuming in your calculation of the average cost of capital
18 that contributions in aid of construction should be included.
19 Contributions in aid of construction are being
20 used to finance rate base. They are not being used to
21 finance CWIP. So if you're financing your rate base with all
22 of your contributions, and then attempting to finance rate
23 base -- or attempting to finance CWIP with it, that's double

- 24 dipping.
 25 The rate that you should be using is the
 1 weighted average cost of capital for your debt and for your
 2 equity and excluding contributions in aid of construction.³⁰

CCA also noted that AUI contended that CIAC should only be used to finance “rate base” and not Construction Work in Progress (CWIP). This would only be reasonable if 100% of AUI’s contributions and grants totaling \$49.75 million (2007 mid-year balance) pertained to asset additions. CCA submitted that to the extent there were contributions and grants related to asset expenditures included as part of CWIP, which had not been transferred out to rate base, AUI’s use of the 6.86% AFUDC rate would not be appropriate. CCA recommended that the Board direct AUI, at its next GRA, to provide evidence as to whether any portion of the contributions and grants were related to projects in CWIP, and if so, to make the corresponding adjustment to the AFUDC rate.

CCA also submitted that the FortisAlberta Inc. (FAI) negotiated settlement reflected a reduction to the mid-year amount of CWIP amounts related to mid-year construction hold-backs and construction accounts payable.³¹ Only the net CWIP amount was subject to AFUDC. CCA considered that AUI should be directed, at its next GRA, to review this treatment and if appropriate, to provide AFUDC calculations in a similar manner.

AUI submitted that neither proposal by the CCA was necessary, as AUI had made it clear on the record how it accounts for CIAC and CWIP. It submitted that there was no need for further evidence or review.³²

Views of the Board

The Board considers AUI’s updated AFUDC rate of 6.86% for 2007 appropriately reflects the weighted average cost of capital for CWIP, excluding any reduction resulting from CIAC which is related to financing rate base. However, the Board agrees with CCA that further investigation into whether or not AUI should apply AFUDC on net CWIP is warranted. Therefore the Board directs AUI in its next GRA to review the treatment of AFUDC on CWIP, and provide an explanation of any areas in which the proposed treatment is not consistent with other Alberta utilities regulated by the Board. In any event, AUI should provide a detailed discussion of its findings, including a full explanation of the rationale underlying any proposed changes.

3.4 CWIP Continuity Schedule

AUI provided a continuity schedule showing the additions and transfers from CWIP to rate base during the year. CCA noted that there were some significant differences in capital expenditures as opposed to capital additions. In 2006, AUI had \$2.0 million in capital expenditures and \$3.5 million in capital additions. In 2007, AUI forecasted \$2.3 million in capital expenditures, but only \$1.4 million in capital additions.

CCA submitted that a review of the capital additions during the year required a detailed project by project analysis of CWIP costs at the beginning of the year, capital expenditures during the

³⁰ Transcript Volume 3, pages 450-451

³¹ CCA Argument, page 9, citing the 2008/09 FortisAlberta Inc. Phase 1 GTA (Negotiated Settlement Agreement), Application 1514140, Schedule 17

³² Exhibit 002-06-01 Schedule 2.8; and Transcript Volume 3, pages 450-451

year, AFUDC, and transfers out to rate base. CCA submitted such a schedule would provide the Board and interveners a better synopsis of the forecast and actual amounts of the various components (capital expenditures, AFUDC, transfers in/out) for a particular test year. CCA suggested that the Board should therefore direct AUI to provide such a schedule as part of its next GRA, both on a project by project basis and in the same format as Schedule 2.3.1 of the current 2007 GRA.

AUI submitted that any material variances between capital expenditures and additions related to differences in timing between the calendar year when capital expenditures were incurred, and the calendar year in which the plant relating to those expenditures goes into service – which was when additions were booked as plant in service.³³

Views of the Board

The Board agrees with AUI that any material variances between capital expenditures and additions relate to differences in timing between the calendar year when capital expenditures are incurred, and the calendar year in which the plant relating to those expenditures goes into service. Therefore the Board does not see the need to direct that a project analysis schedule be provided at this time in respect of projects as raised by the CCA.

3.5 Purchasing Burden

CCA noted that AUI applies a 10% purchasing burden (overhead allowance) to all its purchases of general plant items, meters and regulators.³⁴ AUI noted that the 10% burden had been in place since 2005,³⁵ and that the 2007 forecast purchasing burden of \$159,200 was credited to operating expenses.³⁶

As the 10% was an estimate, CCA submitted that the appropriateness of the 10% purchasing burden should be subject to the same study being undertaken in response to Decision 2005-127 related to capitalized overheads. CCA requested that the Board direct AUI to provide, at its next GRA, a detailed assessment of the appropriateness of the 10% purchasing burden, including a review of the practices of other utilities regulated by the Board.

AUI submitted that any reduction of the purchasing burden allocated to general plant would simply shift the amount from general plant to other plant thereby having no material impact on customers.

Views of the Board

Although the Board agrees with AUI that any reduction of the purchasing burden from general plant will simply shift the amount from general plant to other plant, the Board considers that further explanation and support of the appropriateness of the 10% purchasing burden is warranted. Therefore the Board directs AUI in its next GRA to file an assessment of its purchasing burden. If any changes are proposed to this practice, the Board directs AUI to provide a full explanation of the underlying rationale supporting the change.

³³ Decision U96002 – Centra Gas Alberta Inc. for changes in existing rates, tolls and charges for natural gas utility services supplied by Centra to its customers within Alberta for the test years 1995 and 1996 (File: 1402-1) (Released: January 5, 1996) pages 30-33

³⁴ Exhibit 002-09, Response CCA.AUI-6 (b)

³⁵ Approved in Decision 2006-117 re AUI 2005-06 Compliance Filing #2

³⁶ Exhibit 09-018, Response dated Aug 20, 2007 to CCA IR's on UT Responses

3.6 Capital Expenditures

AUI updated its 2007 forecast of capital expenditures in Exhibit 09-003. AUI's revised 2007 forecast of capital expenditure was \$15,689,300, down \$301,500 from AUI's original filing. Specifically, AUI forecasted capital expenditures of:

- \$7,941,800 for new business,
- \$4,159,800 for system betterment,
- \$3,286,600 for general plant, and
- \$301,100 for costs of removal.

3.6.1 New Business

AUI forecasted 2007 capital expenditures relating to new business of \$7,941,800 based on a forecast of 2000 new service connections and one Rate 13 capital expansion project. The forecasting methodology employed by AUI to determine the number of new connections was based on 2006 actual connections in its service areas, most notably Leduc, Morinville, Stettler and St. Paul, combined with recent actual 2007 service connection applications.³⁷ AUI indicated that it had experienced unforeseen growth in new service connections in 2005 and 2006 and as a result submitted that its reliance on 2006 and partial 2007 actual data should provide a precise forecast of new business and should be accepted by the Board.

The methodology employed by AUI to determine its 2007 forecast capital expenditures relating to new business was based on 2005 actual average unit costs for similar work, that was first adjusted to reflect 2006 contractor and material rates and then further adjusted for the 2006 Alberta consumer price index (CPI) of 4.5%. Land and inspection costs were charged to each project using standard costs; overheads were allocated on a pro-rata basis.³⁸ AUI submitted that its methodology of using adjusted 2005 actual cost data to forecast its 2007 capital expenditures relating to new business was reasonable, resulted in a precise forecast and should be accepted by the Board.

Alberta Urban Municipalities Association and Office of the Consumers Advocate (AUMA/UCA) did not agree with the forecast number of new services, and explored several differences in the detailed cost estimates provided in AUMA/UCA-AUI-5(a). AUI provided a number of undertakings³⁹ to explain these differences. Three of the undertakings resulted in no change to the cost estimates for new business. The undertaking respecting the costs of rural mains provided in Exhibit 09-010⁴⁰ resulted in a reduction of \$71,800 to new business. AUMA/UCA submitted this correction should be incorporated into AUI's compliance filing.

AUI indicated that it would reduce its 2007 forecast of new business by \$71,800 to correct this error.

³⁷ Exhibits 002-01 pages 46-47; 002-06-01 page 40; 002-05 BR-AUI-8; and 09-003

³⁸ Exhibits 002-01 pages 46-47; 002-05 BR-AUI-8; 002-08 AUMA/UCA-AUI-8; 09-018 Undertaking Responses Transcript Volume 1, pages 61-63; and Transcript Volume 1, pages 58-60

³⁹ Transcript Volume 1, page 60, 62, and page 63, line 2

⁴⁰ Transcript Volume 1, page 61

Views of the Board

No party objected to AUI's new business forecast, beyond AUMA/UCA noting the costs of rural mains should be reduced by \$71,800 in accordance with Exhibit 09-010. Having reviewed Exhibit 09-010, the Board agrees with both AUI and the AUMA/UCA that rural mains should be reduced by \$71,800. Therefore, the Board directs AUI, in its Refiling, to reduce its 2007 forecast of rural mains by \$71,800.

The Board approves AUI's 2007 new business capital expenditures forecast, subject to AUI applying the aforementioned reduction of \$71,800 associated with rural mains.

3.6.2 System Betterment

In relation to AUI's system betterment projects, AUI forecasted 2007 capital expenditures of \$4,159,800. The forecast expenditures relate to looping, metering, replacement of service lines and gas supply projects required to provide utility service within its service area. AUI indicated that it intended to complete all system betterment projects in 2007.⁴¹

3.6.2.1 Leduc South Purchase Meter Station (PMS) – Gas Supply

In its Application, AUI originally forecast a direct cost of approximately \$431,000 for the Leduc South PMS – gas supply project. Subsequent to its original filing, AUI further refined its engineering design for the project with the result that its forecast direct costs increased for labour and additional project components such as line heating and odorization equipment. AUI also incurred significantly higher land acquisition costs than originally forecast, which increased the direct costs forecast for the project. The final forecast cost of the project was \$954,900. AUI filed a business case which indicated that the project was required to ensure adequate supply and system pressure in the Leduc area due to significant service growth.⁴²

Reviewing the updated cost estimates, AUMA/UCA noted that the unit cost of trenching for the 219 mm pipe increased from \$18.81 per meter to \$40.00 per meter and the unit cost of labor for the 219 mm pipe increased from \$94.05 to \$200.00 per meter. AUMA/UCA submitted that both of these revised estimates were not consistent with the other unit costs for trenching and labor as included in section 3.3.1.6 of the Application. Given that the project was still in the design stage, AUMA/UCA submitted that the original costs for these two items should be used, resulting in reductions of \$32,000 and \$28,000 for pipe and labour respectively.

AUI submitted that the evidence with respect to these two line items referenced by AUMA/UCA, and more particularly the unit costs for those line items, reflected the most up-to-date cost information at the time the update was filed. AUI submitted that the Board should approve the revised forecast amount for this project as filed.⁴³

Views of the Board

Although AUI did not provide detailed justification of the changes in unit costs for trenching and labor, the Board is prepared to accept the revised forecasts as reflecting the most up-to-date information available. However, in future applications, AUI should provide a full explanation of any significant changes in underlying cost inputs in capital expenditures to allow for adequate

⁴¹ Transcript Volume 1, pages 174, 179-184; Transcript Volume3, pages 508-513, 608-609 and Exhibit 09-016

⁴² Exhibit 002-01, pages 73-78

⁴³ Exhibit 09-018 Undertaking Response Transcript Volume 3, page 513; and AUI Argument at pages 14-15

testing by the Board and interveners. Therefore the Board directs AUI in future applications to provide a full explanation of any significant changes in underlying cost inputs in capital expenditures, as compared to the original application.

The Board approves AUI's forecast of \$954,900 for the Leduc south PMS project as updated in Exhibit 09-018.

3.6.2.2 General Looping

In the Application, AUI forecast a direct cost in 2007 of approximately \$251,000 for all looping projects. Subsequent to its original filing, AUI determined that the looping projects for the towns of Westlock and Three Hills were not required in 2007. Concurrently, AUI identified a general looping provision with a 2007 direct forecast cost of \$338,800 to address a further 11 looping projects, all of which are required in 2007. As a result of the cancellation of the Westlock and Three Hills looping projects and the addition of the general looping provision, AUI's 2007 forecast direct cost for looping was revised to \$428,600.⁴⁴

AUMA/UCA noted that AUI could not provide a business case for the "various" rural looping projects but indicated that it had identified about \$185,000 in direct costs authorized for expenditure in 2007;⁴⁵ further, Exhibit 09-016 indicated that AUI had authorizations for expenditures (AFE's) totaling \$213,000. However, the Ponoka-Leduc Area looping was specifically included in Table 3 revised⁴⁶ and thus should be excluded from the "various" looping projects, reducing the total "various" looping projects with AFE's to \$185,600. Adding 24% for overheads (per Table 3 revised), to the \$185,600 increases the costs of the "various" looping projects to \$230,000 and the total cost for looping projects to \$340,600. AUMA/UCA pointed out that the average cost for looping projects over the 2003-2006 period was \$284,000.⁴⁷ On this basis, AUMA/UCA submitted that there was no justification for "various" rural looping projects beyond \$230,000. Accordingly the subtotal for looping projects should be reduced by \$187,200 to \$340,600 for 2007.

In Decision 2005-127 the Board directed AUI to provide business cases for all planned capital expenditures in excess of \$50,000. AUI submitted that it met this directive in the Application by including business cases for all system betterment and general plant expenditures, including its forecast looping projects.⁴⁸ AUI indicated that only one of its 2007 forecast looping projects was forecast to exceed \$50,000 in direct costs, consequently AUI did not prepare business cases for all of its other looping projects as the forecast costs were less than \$50,000.⁴⁹ Similarly, AUI did not provide a business case for its 2007 forecast of \$70,000 for a general looping provision since it was intended to be an allowance for looping projects not yet identified.⁵⁰

⁴⁴ Exhibits 002-01 page 54; 002-06-01 page 42; 09-003 Table 3 (Rural Main, 60.3, Various); 09-016; and Transcript Volume 1, pages 18-19, pages 188-190; and Transcript Volume 3, pages 508-510

⁴⁵ Transcript Volume 3, page 508

⁴⁶ Exhibit 09-003 System Betterment – Detail 3.1.2.1, Table 3 -2007 Forecast Update -V2, page 3 of 4

⁴⁷ Exhibit 002-008, AUMA/UCA-AUI-6(a)

⁴⁸ *Supra* note 18 at page 13. Exhibits 002-01 pages 52-103; 002-09 CCA-AUI-12; 002-10 MGCI-AUI-23; and 002-12 AUMA/UCA-AUI-18 and 21

⁴⁹ Exhibit 09-003 Schedule 3.1.2.1 System Betterment – Detail Table 3; 09-16; and Transcript Volume 1, page 189 and Transcript Volume 3, pages 508-509

⁵⁰ Transcript Volume 1, pages 18-19 and 189; and Transcript Volume 3, pages 508-509

AUI noted that interveners suggested that AUI's 2007 forecast for looping double counted AUI's Leduc-Ponoka area looping project;⁵¹ however, this was not the case. AUI stated that the looping component of its system betterment forecast totaled \$322,500 in direct material and labour costs, which consisted of: \$48,600 for Stettler looping; \$19,200 for Leduc-Ponoka looping; approximately \$185,600 relating to 11 specific looping projects for which AFEs have been issued; and approximately \$69,100 in the general looping provision.⁵²

Views of the Board

After an extensive review of various transcript references, exhibits, AUI's original and revised application, the Board is satisfied that AUI has adequately explained its revisions to forecast looping expenditures. Further, the Board considers that these looping expenditures fall below the threshold required for filing business cases. Therefore the Board approves AUI's forecast looping expenditures.

3.6.2.3 Service Lines

AUMA/UCA noted that AUI had forecast replacing 150 service lines in 2007 at a cost of \$579,000;⁵³ this estimate was updated to \$553,500 or \$3,690 per service line. However, during the hearing, AUI undertook to provide a detailed cost estimate in support of the 150 service lines to be replaced. AUI provided Exhibit 09-010, which indicated that after adding 24% for overheads (per AUMA/UCA-AUI-6c), the revised cost for 150 service line replacements were \$276,498 or \$1843 per service line. AUMA/UCA considered that this was comparable with the 2001-2006 average of \$1722 per service line. AUMA/UCA submitted that the revised estimate of replacing 150 service lines per Exhibit 09-010 of \$276,498 including overheads should replace the April 26, 2007 updated estimate of \$553,500, for a reduction of \$277,002.

AUI submitted that the AUMA/UCA proposed reduction was in keeping with its revised 2007 Forecast Update amount for service line replacements of \$274,600, which was the amount that the Board should approve.⁵⁴

Views of the Board

AUI revised its 2007 Forecast Update amount for service line replacements to \$274,600⁵⁵ (from its original forecast of \$579,000), which is consistent with AUMA/UCA's recommendation. The Board concurs with AUI's revision to service line replacements as a sub-component of system betterment as it appropriately reflects AUI's revised cost estimates and is generally consistent with the 2001-2006 average of \$1,722 per service line. On this basis, the Board approves AUI's forecast of \$274,600 for service line replacements.

3.6.2.4 Updated Capital Expenditures

MGCI noted that several projects included in the original forecast costs were not proceeding and that these costs should not be included in the 2007 revenue requirement. MGCI understood that

⁵¹ AUMA/UCA Argument, page 3

⁵² Exhibits 09-03 Schedule 3.1.2.1 System Betterment – Detail Table 3; 09-16; and Transcript Volume 1, page 189 and Transcript Volume 3, pages 508-509

⁵³ Exhibit 002-01, Application, page 54

⁵⁴ Exhibit 09-003 Schedule 3.1.2.1 System Betterment – Detail Table 3

⁵⁵ Exhibit 09-003 Schedule 3.1.2.1 System Betterment – Detail Table 3

all of these changes were included in the updated forecast incorporated into Exhibit 09-003 filed on the first day of the hearing.

Views of the Board

Based on the number of updates and revisions to system betterment capital expenditures and other costs items within AUI's revenue requirement, the Board directs AUI in the Refiling to update all capital expenditure schedules to reflect the findings within this Decision and the updated evidence on the record in this proceeding.

In future proceedings, the Board considers that it would be more efficient and lead to greater transparency if updates were more clearly indicated. To this end, the Board directs AUI, in future proceedings when updates are made, to produce both a full narrative explanation of the reasons for the changes, along with a table indicating the changes made to the original application, including the original amount, the updated amount, and the magnitude of each change.

3.6.3 General Plant

AUI forecast 2007 capital expenditures of \$3,286,600, which represented a \$700,000 reduction from its original 2007 forecast amount of \$3,986,600.⁵⁶ Forecast expenditures related to office and shop facilities required to accommodate staff additions and increased operational requirements due to increasing service demands. The forecast expenditures also included additional office furniture, vehicle fleet, information technology infrastructure, tools and equipment.⁵⁷ Similar to its forecast system betterment projects, AUI provided information relating to need, alternatives and costs in various business cases for its general plant expenditures forecast to exceed \$50,000.⁵⁸

Intervenors did not object to AUI's 2007 forecast of general plant expenditures.

Views of the Board

The Board has reviewed AUI's forecast general plant capital expenditures and determined that the forecast appears to be reasonable. Based on the number of updates and revisions to capital expenditures and other cost items within AUI's revenue requirement, the Board directs AUI in the Refiling to update all schedules to reflect all findings within this Decision and the updated evidence on the record in this proceeding.

4 NECESSARY WORKING CAPITAL

Necessary working capital (NWC) refers to the funds that represent the investment in materials, supplies and cash needed to meet current obligations. A working capital allowance is included in rate base to compensate investors for the cost of capital supplied to cover the lag between expenditures and their recovery. Subsection 37(2)(b) of the GUA obligates the Board, in fixing just and reasonable rates, to give due consideration to the cost of NWC employed by a utility in providing utility service.

⁵⁶ Exhibits 002-06-01, page 45; and 09-003

⁵⁷ Exhibits 002-01, pages 88-90; 002-05 BR-AUI-11; and 002-09 CCA-AUI-9 and 10

⁵⁸ Exhibits 002-01, pages 91-103; 002-09 CCA-AUI-12; and 002-12 AUMA/UCA-AUI-18

AUI used two methods to determine its 2007 forecast for NWC: a mid-year calculation for all working capital components, other than cash, and a lead-lag study for cash working capital. Both of these methods have been historically used by AUI and were most recently approved by the Board in AUI's 2005-2006 Phase I GRA.⁵⁹ The 2007 NWC forecast provided as part of AUI's 2007 Forecast Update filing reflected all the updates in that filing.⁶⁰

AUI's 2007 mid-year forecast for NWC was \$2,895,280, which was an increase of approximately \$809,000 over AUI's 2006 actual mid-year NWC and an increase of approximately \$1,510,000 over AUI's 2006 approved mid-year NWC. This increase was in part due to a forecast increase in cash working capital which was mainly attributable to increasing salaries and wages and increasing "other" operating, maintenance and administration costs.⁶¹ The increase in operating, maintenance and administrative expenses are discussed in Section 6 of this Decision. The increased NWC was also in part due to the inclusion of deferred CEO/CFO certification costs,⁶² which are discussed in Section 4.5 of this Decision.

To account for changes in both vendors' and AUI's practices, as well as changes in customers' payment practices, AUI conducted an analysis of actual 2005 lead-lag times for key elements of its revenue and expenses in order to calculate cash working capital. AUI determined that the lag time increased for revenue and for some of the larger expense components, such as salaries and wages. Overall, AUI's 2007 forecast cash working capital requirements were approximately \$750,000 greater than the 2006 allowed forecast and \$735,000 greater than the normalized 2006 actual.⁶³

The lead-lag analysis AUI undertook was in keeping with a cost of service model of regulation as the lead and lag times determined were based on actual data. Similarly, the other components of AUI's 2007 forecast for NWC were forecast on the basis of actual amounts, which were adjusted to reflect AUI's anticipated changes for 2007. Compensation only for those costs employed in the provision of utility service would be consistent with cost of service regulation.

4.1 Revenue Lag from 37.3 to 41.6 Days

AUI forecast its 2007 revenue lag based on an analysis of 2005 billing data taken from its customer information and manual billing systems. The analysis used more than half of AUI's customer base, taken from all distribution rate classes, except irrigation, which involved a sample of approximately 32,000 customer accounts. AUI determined that its average revenue lag⁶⁴ increased from the previously approved revenue lag of 37.3 days to 41.6 days.⁶⁵ The revenue lag associated with the goods and services tax for other expenses and capital expenditures remained unchanged at 45.6 days.

CCA argued that AUI first proposed to increase its revenue lag by 4.3 days because of a longer bill distribution time than previously thought,⁶⁶ but then revised its position to state that the

⁵⁹ Exhibit 002-01, page 104 and Decision 2005-127, pages 13-14

⁶⁰ Exhibit 002-06-01

⁶¹ Exhibit 002-06-01 Schedules 2.3.3 and 4.1.3

⁶² Exhibits 002-06-01 Schedules 2.3.3 and 4.1.3; and 002-05 BR-AUI-12

⁶³ Exhibits 002-01 pages 104-111; and 002-06-01 Schedule 2.3.3

⁶⁴ Exhibit 002-01 page 104. Revenue lag was determined based on the measure of time between the mid-point of service to customers and receipt of payment from customers.

⁶⁵ Exhibit 002-01 pages 104-105; and Transcript Volume 3, pages 462-470

⁶⁶ Exhibit 002-01 Section 4.1.2, page 105

increase was related to a change in the collection lag due to customer behaviour. CCA noted AUI's statement that customer payments trend towards the due date of the statement and customers were now making significant use of electronic payment methods, primarily internet bank payments and automated bank payments.⁶⁷

Based on AUI's revised explanation of the lag, CCA concluded that there were six functions prior to the actual mailing of a bill to AUI's customers:

1. Meter reading upload to the customer information system
2. Billing calculations
3. Meter reading and bill calculation verifications
4. Electronic file preparation
5. Transmission to the bill print provider
6. Bill print

CCA noted that AUI acknowledged that, while a number of the steps were electronic processes, there were other steps such as in the verification process which were not necessarily completely automated and also involve manual processes. However, CCA submitted that, as most of the above functions were automated, once the meter reading was loaded into the customer information system, there was no rationale for billing calculations and other related functions to cause delays of up to six working days. CCA argued that AUI advanced no evidence to suggest why steps involving manual processes would currently take more time than needed in prior years.

CCA noted that ATCO Gas provided for a revenue lag of 35.8 days in its 2005-2007 GRA, and that in its 2003-2004 GRA, ATCO Gas' approved revenue lag was 38 days, which was prior to its decision to exit the retail function. CCA considered that AUI's approved revenue lag of 37.3 days compares favorably to the 2003-2004 ATCO Gas revenue lag of 38 days.

CCA considered that AUI presented contradictory evidence in respect of the proposed increase of 4.3 days in revenue lag, which caused the reason for the increase to be uncertain. Consequently, CCA submitted that the Board should reject the proposed increase in the revenue lag and direct AUI to refile its 2007 GRA using the last approved revenue lag of 37.3 days.

AUI submitted that the increase in the revenue lag days was due to an increase in the collection lag, which was 4.3 days longer than the previously estimated 16.8 days. AUI concluded that the increase could only be attributable to customers paying their bills closer to the due date and this was in turn likely attributable to significant use of electronic payment methods.⁶⁸

AUI disagreed that it did not advance any evidence to suggest why the steps involved in the meter reading, billing and payment process require an additional 4.3 days to complete. AUI submitted that its revenue lag evidence was based on a comprehensive revenue lag study of actual billing and collections data for approximately one-half of its customer accounts.

Further, interveners incorrectly attributed the increase in revenue lag to the billing portion of revenue lag, whereas AUI's evidence indicated that the increase in revenue lag was solely

⁶⁷ Exhibit 002-09, Response CCA AUI-18 (b)

⁶⁸ Exhibits 002-01 pages 104-105; 002-09 CCA-AUI-18; and Transcript Volume 3, pages 463-469

attributable to the change in the collections component of revenue lag, which increased from 16.5 to 20.8 days.⁶⁹

AUI submitted that, in attempting to find fault in the billing lag of 5.6 days, interveners relied on the implication that billing processes that are electronic, or automated, are faster and that the billing functions cause delays of up to 6 working days. AUI stated that the billing functions require four to six calendar days and takes into account that weekends affect cyclical billing, which interveners had not taken into account. AUI noted that in the 2005-2006 GRA, by incorrectly estimated the billing lag as being two days, it failed to account for one day for meter reading and two days for weekends, which now has led to the correct billing lag of 5.6 days.⁷⁰

In the absence of evidence comparing ATCO Gas's revenue lag calculations and billing systems (including all the components from meter reading to bill mailing and payment); AUI submitted that ATCO Gas' revenue lag was not relevant to a determination of AUI's revenue lag. AUI submitted that the Board should attach no weight to ATCO Gas' revenue lag, as revenue lag was a subjective utility specific attribute. As an example of subjectivity between utilities, AUI stated that its approved payment term of 21 calendar days⁷¹ compared to ATCO Gas' approved payment term of 13 business days⁷² demonstrated why ATCO Gas has a shorter revenue lag than AUI.

Views of the Board

While AUI referred to its revenue lag study that involved 32,000 of its customers, it did not file this study in order to allow it to be reviewed and tested in this proceeding. AUI considers revenue lag to be a subjective utility specific attribute, and stated that its previously approved revenue lag was erroneous. Referencing the study, but not filing it as evidence in this proceeding, does not persuasively demonstrate to the Board that the updated analysis has corrected a previous error, particularly if any measure of subjectivity is involved.

The Board agrees that customers would tend to pay bills close to the stated due date but is not convinced that AUI has adequately substantiated the cause for the bill delivery to customers to increase from 16.5 days to 20.8 days.⁷³ The Board therefore denies AUI's request for the proposed increases in its revenue lag to 41.6 days. The Board directs AUI in its Refiling, to use the previously approved revenue lag of 37.3 days for purposes of determining NWC for the 2007 test year.

With regard to the arguments made by the parties regarding ATCO Gas's revenue lag, in making its determination, the Board did not consider that the circumstances involving ATCO Gas were readily comparable with those of AUI and therefore gave no weight to ATCO Gas' revenue lag.

⁶⁹ Exhibit 002-09 CCA-AUI-18

⁷⁰ Exhibits 002-01 pages 104-105; and 002-09 CCA-AUI-18

⁷¹ Order [U2005-211](#) – AltaGas Utilities Inc. 2003-2004 GRA Phase 2 - Compliance Filing (Application 1399882) (Released: Jun 1, 2005)

⁷² Decision [2006-075](#) – ATCO Gas 2003-2004 General Rate Application Phase II Part 2 Terms and Conditions of Service (Application 1416346) (Released: July 27, 2006), at Appendix 1 “Terms and Conditions for Distribution Access Service,” page 29 of 70

⁷³ Exhibit 002-09, Response to CCA-AUI-18(a), 18(e)

4.2 Changes in Expense Lags from Decision 2005-127

AUI conducted an analysis of actual 2005 lead-lag times for several key elements of its expenses making up its cash working capital component of NWC. AUI's 2007 forecast left the majority of expense element lead-lag times effectively unchanged from those approved in Decision 2005-127. Interest on long term debt (LTD), municipal taxes and property taxes were those expense elements that were forecast as having material changes in lag times as a result of AUI's analysis. The lag related to gas cost expense was not used in determining AUI's cash working capital.

AUI's last approved lag time for interest on LTD was 91.5 days. However, for 2007 AUI forecast a change from 91.5 days to 45.6 days. This change in lag was driven by, and reflective of, a change in the timing of AUI's interest payment obligations. AUI's debt matured in 2005 and prior to maturity, interest obligations were semi-annual (lag time being 91.5 days) whereas AUI's new debt interest obligations are quarterly (lag time being 45.6 days).⁷⁴ Consequently, AUI submitted that the 2007 forecast cash working capital attributed to interest on LTD was based on actual interest obligations and was in turn consistent with cost of service principles.

AUI's change in lag times for both municipal and property taxes were based on AUI's actual experience with respect to when payment of such taxes was due along with an adjustment to separate Leduc office municipal taxes and all other property taxes. As such, AUI submitted that the lag times and associated costs of NWC were consistent with cost of service principles.

Based on the change in the interest payment requirements associated with the current debt, the CCA agreed with the proposed change to 45.6 days.

CCA noted that AUI's working capital forecast in respect of municipal taxes included a prepayment that was three days in advance of the due date of June 30.⁷⁵ CCA recommended that, as there was no requirement to prepay the Leduc property taxes, the net lag for 2007 municipal taxes should be changed to 41.6 days from 44.6 days.

AUI submitted that some amount of lead time was necessary to avoid incurring any late payment penalty. AUI noted that the mid-point of its service period was July 2 and the due date of June 30 was two days ahead of the mid-point of service, which supported a lead for payment of municipal taxes of at least two days. However, AUI stated that it would not oppose a reduction in AUI's net lag for 2007 municipal taxes by three days from the applied for amount of 44.6 days to 41.6 days.⁷⁶

Views of the Board

For purposes of forecasting, the Board finds the due date of the municipal taxes to be the appropriate lag time to be reflected in the revenue requirement. The Board will therefore accept the CCA's recommendation to reduce the net lag period for municipal taxes by three days. The Board notes that AUI was not opposed to this reduction. Therefore the Board directs AUI, in its Refiling, to use a net lag period of 41.6 days to determine NWC associated with municipal taxes.

⁷⁴ Exhibits 002-01, page 108 and Schedule 4.1.20; 002-06-01 Schedule 4.1.3; and 002-09 CCA-AUI-20.

⁷⁵ Transcript Volume 3, page 475

⁷⁶ AUI Reply Argument, page 13

4.3 EUB Special Deposit

AUI's 2007 forecast for NWC included an amount of \$194,300 for reclamation deposits (EUB Special Deposits) in respect of non-producing wells owned by AUI.⁷⁷

CCA submitted that, as part of AUI's working capital, AUI earns a rate of return equal to the composite cost of capital, i.e., 4.651%, in 2007⁷⁸ and, as well, earns interest at a rate of 4.75% on the EUB Special Deposit amounts.⁷⁹ CCA noted that AUI did not include interest income in its forecast revenue requirement.⁸⁰ Consequently, CCA argued that, as AUI earns interest on the EUB Special Deposit, there is no need to include these amounts in NWC as doing so amounts to double collecting. CCA recommended that if the Board allowed the EUB Special Deposits to be included in NWC, it should also direct AUI to include the interest recovery as a revenue offset in its 2007 forecast revenue requirement.

AUI considered that the EUB Special Deposits were investor capital that was held by the Board in accordance with Board regulations and as such should be approved by the Board as part of AUI's NWC. AUI, however, did not object to the CCA's recommendation to include any related interest income from the EUB Special Deposits as a revenue offset.

Views of the Board

The Board notes that the EUB Special Deposits were previously approved as a component of NWC in Decision 2005-127 and agrees with AUI that their inclusion in NWC remains appropriate. However, the Board considers that fairness dictates any interest earned on those deposits should also be taken into consideration by AUI. Therefore, the Board directs AUI, in its Refiling, to include its estimate of the interest to be earned on the EUB Special Deposits as a revenue offset.

4.4 Deferred Regulatory Account

AUI forecast that its deferred regulatory account will reach a zero balance by the end of 2007.⁸¹ The deferred regulatory account includes forecast costs pertaining to utility proceedings and annual assessments from the EUB and UCA.

4.4.1 Utility Proceeding Costs

AUI's regulatory forecast included \$150,000 related to its review and variance (R&V Application) of Decision 2006-049.⁸² In a subsequent update, AUI reduced the forecast costs pertaining to its R&V Application by \$74,200 to include in its deferred regulatory account only actual costs of approximately \$75,800 that it had experienced to date.⁸³ The Board dismissed the R&V Application.⁸⁴

⁷⁷ Exhibit 002-06-01, Application Update, Section 4.2.3, Table 6, page 54

⁷⁸ Exhibit 002-06-02, Schedule 2.8

⁷⁹ Transcript Volume 3, page 487

⁸⁰ Transcript Volume 3, page 478

⁸¹ Exhibits 002-01 pages 118 and 198 and Schedule 4.2.5.1; 002-06-01 page 55 and Schedule 4.2.4.1

⁸² Exhibits 002-01 page 198 and Schedule 4.2.5.1; 002-06-01 pages 55 and 69 and Schedule 4.2.4.1; and Transcript Volume 1, page 28 and Transcript Volume 3, page 564

⁸³ Exhibit 002-06-01, page 55

⁸⁴ Exhibit 002-17, page 4

The CCA argued that [EUB Directive 31B](#), the Board's directive for Utility Cost Claims (Directive 31B), was very clear respecting costs associated with a failed review and AUI's Argument regarding the leave to appeal application constituted new evidence. The CCA requested that the Board direct AUI to remove all R&V Application costs related to Decision 2006-049 from its revenue requirement.

AUI argued that it was premature for the Board to deny AUI's costs associated with the R&V application pending the outcome of AUI's leave to appeal applications with respect to both Board Decision 2006-049 and the Board's decision on the R&V Application. AUI argued that notwithstanding the outcome of the initial R&V Application, some of the costs that were incurred while preparing for the R&V Application would be useful in responding to a Board directive in Decision 2006-049 dealing with a future debenture application by AUI.

AUMA/UCA noted that AUI estimated the cost of the Application (one year test period) to be \$250,000⁸⁵ and that the cost of the 2005-2006 Phase I (two year test period) was also about \$250,000.⁸⁶ Given that the Application was for a one year test period, AUMA/UCA submitted that AUI should bear one-half of the actual costs of the 2007 Phase I GRA, or \$125,000, for purposes of the 2007 forecast.

AUI disagreed with AUMA/UCA that it should bear the additional costs associated with a single test year. AUI considered that the potential additional hearing costs of approximately \$125,000 associated with AUI's single 2007 test year GRA were not unreasonable given the likely benefit to both ratepayers and AUI arising from a revenue requirement in future years that more closely matches current expectations and conditions. AUI argued that denial of any recovery of hearing costs would:

1. penalize AUI and send a message to utilities not to deviate outside of their typical, or *status quo*, test periods for GRAs when they believe they are facing significant forecasting risk, which is not in the interest of either ratepayers or utilities, and
2. be inconsistent with the RRR Regulation that outlines that utilities are entitled to their prudently incurred costs in the provision of gas utility service.

Views of the Board

In past years, the Board has from time to time considered the recognition of events or costs that have occurred after revenue requirement forecasts were prepared. In a number of circumstances, the Board has substituted forecasts with updated 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.⁸⁷ The Board has also stated that it should have the best available

⁸⁵ Transcript Volume 1, page 47

⁸⁶ Exhibit 002-08, response to AUMA/UCA-AUI-2(e)

⁸⁷ See for example: Decision [U97065 Vol. 1, Vol. 2](#), 1996 Electric Tariff Applications Alberta Power Limited, Edmonton Power Inc., TransAlta Utilities Corporation, Grid Company of Alberta, dated October 31 1997 (opening balances); Decision [2000-9](#) Canadian Western Natural Gas Company 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).

information before it at the time it must make its decision, in order to assist it in determining a revenue requirement for the utility that most closely matches current expectations and conditions.⁸⁸

In this proceeding, AUI identified a number of areas in which more recent information suggests that costs are expected to be either higher or lower than forecast.⁸⁹ In its opening statement, AUI indicated that the Board had refused its R&V Application, however AUI did not update its forecast. Rather, it took the position that those costs will assist it in responding to another Board direction.⁹⁰

In Decision 2006-004, the Board considered whether costs in excess of those normally permitted under the Board's Scale of Costs⁹¹ should be approved in a utility's revenue requirement. The Board stated:

Section 68 of the PUB Act provides the Board with the jurisdiction to award costs with respect to utility proceedings. It further provides that the costs are in the discretion of the Board and that the Board may prescribe a scale pursuant to which costs are to be awarded. Part 5 of the Board's Rules of Practice provides a process by which a "participant" may apply for payment of costs incurred in a utility proceeding. "Participant" includes a utility applicant. Rule 55(1)(a) provides that the Board may award costs, in accordance with the Scale of Costs, to a participant if the Board is of the opinion that the costs are reasonable and directly and necessarily related to the proceeding ...

In accordance with its statutory authority to deal with costs of regulatory proceedings in the manner it finds appropriate, the Board has determined its cost recovery process as the exclusive mechanism for the recovery of all reasonable external legal and consulting costs, properly incurred for all participants, including utility applicants. AG must avail itself of that process and the mechanisms thereunder for recovery of costs incurred in excess of the Scale of Costs if it wishes to have recovery of those costs from ratepayers. The Board considers that it is appropriate that all external legal and consulting costs related to regulatory proceedings that are to be recovered through rates should be included in the hearing cost reserve account following consideration through the Board's cost recovery process....

With respect to costs in connection with appeals of Board decisions, the Board sees these costs as costs incurred for the benefit of the utility's shareholders and accordingly are not appropriate to be recovered through utility rates. The Board also notes that a separate cost recovery mechanism may be available in some circumstances to successful participants in the appellate process.⁹²

⁸⁸ See for example Decision [2006-004](#) – ATCO Gas 2005-2007 General Rate Application Phase I (Application 1400690) (Released: January 27, 2006) [SEE ALSO Decision [2006-014](#) for Errata to this Decision ATCO Gas 2005-2007 General Rate Application – Phase I Errata of Decision 2006-004 (Released: February 24, 2006)], pages 3 and 6.

⁸⁹ For example, see Exhibits 002-06, 002-06-01, 002-06-02, 002-06-03, Transcript Volume 1, pages 17-30 and 188-90, Transcript Volume 3, pages 422 and 508-510, Exhibits 09-003, 09-010

⁹⁰ AUI Argument page 31, citing Transcript Volume 3, pages 562-563 and Decision 2006-049, page 4

⁹¹ As provided for in EUB Directive 31B, Utility Cost Claims

⁹² Decision 2006-004, pages 100-102

In Decision 2006-004, the Board also stated that it is through the Board's cost process that the reasonableness of all costs incurred in connection with a regulatory proceeding are intended to be reviewed, tested and adjudicated upon. Directive 31B states:

...The Board will not ordinarily award costs for ...
Costs related to an appeal of a decision of the Board to the Alberta Court of Appeal...⁹³

...It is the Board's view that customers should not be required to bear the costs associated with a failed review request initiated by a utility as, in the Board's view, there is little, if any, customer benefit associated with such a process.⁹⁴

Directive 31B demonstrates that the Board has established a specific process in which it will consider participant costs incurred in connection with proceedings before it. The process applies to cost recovery for both utility applicants and interveners. Participants bear the onus to demonstrate that their costs are appropriate for reimbursement in accordance with Directive 31B or to demonstrate to the satisfaction of the Board that special circumstances exist so as to merit a cost award in excess of those permitted under Directive 31B.

The Board does not consider it appropriate for AUI to seek recovery from ratepayers of costs that are not permitted to be recovered through the Board's cost recovery process through a forecast account in a GRA. To allow AUI to recover these costs from ratepayers through a GRA would be to allow AUI to indirectly circumvent Directive 31B and the principles underlying it.

The Board notes that AUI updated the forecast costs for its 2007 Phase I GRA to approximately \$362,000, for inclusion in its deferred regulatory account.⁹⁵ The Board also notes that these costs are significantly in excess of the amounts, incurred for its 2005-2006 Phase I GRA. While the Board is not convinced that it should disallow AUI's forecast costs for the 2007 Phase I GRA in the amounts as submitted by AUMA/UCA, the Board considers that the amount to be included in the deferred regulatory account should be reduced. For purposes of the Application, the Board considers that AUI's original forecast costs of \$239,500⁹⁶ would be an appropriate amount to include in the deferred regulatory account. Therefore the Board directs AUI in the Refiling to use the amount of \$239,500 for the 2007 Phase I GRA costs in its deferred regulatory account and to reflect that amount and the related amortization in its Refiling. The Board notes that all actual hearing costs, which may be in excess of the forecast amounts, are subject to Directive 31B, and expects AUI to demonstrate to the Board's satisfaction in the cost claim process that its costs have been prudently incurred.

The Board also finds that AUI has not demonstrated that the costs respecting the R&V Application are reasonable for recovery during the 2007 test period. Accordingly, the Board disallows these costs. The Board directs AUI, in its Refiling application, to remove from AUI's deferred regulatory account the amount of \$75,800 incurred or forecast in respect of its R&V Application and to adjust its revenue requirement to reflect the reduced amortization of deferred regulatory costs resulting from the disallowed costs.

⁹³ EUB Directive 31B, Section 5.1

⁹⁴ EUB Directive 31B, Section 9.1

⁹⁵ Exhibit 002-06-02, Schedule 4.2.4.1

⁹⁶ Exhibit 002-01, Schedule 4.2.5.1

Further the Board directs AUI in its Refiling to provide a reconciliation of its deferred regulatory account setting out the details of amounts forecast, amounts actually incurred, with reference to any related cost claims approved by the Board, and amounts disallowed between the previously approved forecast balance at December 31, 2006 and the revised balance at December 31, 2007.

Parties disagreed with the inclusion of the EUB and UCA assessment amounts in the deferred regulatory account. These matters are dealt with in the following sections.

4.4.2 EUB Assessment Costs

CCA noted that AUI included an amount of \$230,600 in respect of the 2007 EUB assessment as part of the deferred regulatory costs included in NWC. CCA argued that, based on its review of recent general tariff application decisions, the Board's treatment of the EUB assessment costs does not appear to be consistent across all EUB regulated utilities. For example, AltaLink Management Limited does not appear to include the EUB assessment costs in its hearing cost reserve (i.e. deferred regulatory) account⁹⁷ whereas FAI includes them in its hearing cost reserve account.⁹⁸

The CCA submitted that costs included in the deferred regulatory account must meet the tests applicable to any cost item for which a deferral account is set up:

- 1) the costs must be difficult to forecast; and
- 2) the costs must be subsequently approved by the Board for disposition.

With respect to the first criterion, CCA submitted that deferral account treatment would be justifiable if there was some significant uncertainty that the actual EUB assessment costs would be significantly higher than the forecast amounts. With respect to the second criterion, CCA noted that all costs paid through the deferred regulatory account must be specifically approved for payment by the Board by way of a Board cost order, but AUI does not need any such approval with respect to the EUB assessment costs as the Board does not issue a cost order approving its own costs. CCA therefore recommended that the Board direct AUI to remove the EUB Assessment Costs from its deferred regulatory account, as these costs should be part of AUI's normal operating costs included in revenue requirement.

AUI submitted that the purpose of the deferred regulatory account was to account for hearing costs, which include the EUB assessments, and consequently the test for establishing a deferral account does not apply. AUI also submitted that the EUB assessment costs were included in the deferred regulatory account in accordance with a direction from the Board. Regardless, AUI argued that the test for establishing a deferral account was met with respect to the assessment, in that:

1. the EUB assessment is difficult to forecast (AUI's 2006 actual cost for its EUB assessment was \$85,300 greater than in 2005 – some 64%),⁹⁹ and
2. through a Board approval of AUI's 2007 forecast for the EUB assessments, the Board would be effectively approving the costs for disposition.

⁹⁷ AML 2007-08 GTA Refiling, Schedule 5.1, Application 1507819

⁹⁸ FAI 2006-07 GTA, Application 1434992, Schedule 19

⁹⁹ Exhibit 002-09 CCA-AUI-38(a) AltaGas Utilities Deferred Regulatory Costs: 2005 and 2006 Actual EUB Assessment costs \$134,300 and \$219,600 respectively.

Views of the Board

Because of concerns of estimating the annual EUB assessment, the Board had previously agreed that AUI should recover the assessed costs through the deferred regulatory account.¹⁰⁰ Therefore, the Board approves the treatment of the EUB assessment in the manner and amount as filed by AUI.

4.4.3 2007-2008 UCA Assessment Costs

CCA noted that AUI included an amount of \$58,000 for the 2007- 2008 UCA assessment. As the CCA considered that the 2007 - 2008 UCA Assessment costs were similar to the EUB assessments costs, it recommended that they should likewise not be included in the deferred regulatory account.

AUI also argued that the UCA assessment cost were similar to the EUB assessment costs, and therefore should be treated similarly in the deferred regulatory account.

Views of the Board

The Board agrees that the UCA assessment costs are similar to the EUB assessment costs and also considers that the annual assessment amounts may be subject to the uncertainty involved in forecasting. The Board therefore accepts that the UCA assessment costs should be included in AUI's deferred regulatory account and approves the amount as filed.

4.5 Deferred CEO/CFO Certification Costs

AUI indicated that CEO/CFO certification was required for all publicly listed corporations because of certain securities regulatory reporting requirements for publicly traded corporations.¹⁰¹ The Board understands that these rules and proposed rules are being proposed by the Canadian Securities Administrators (CSA) following implementation of the Sarbanes Oxley Act (SOX) in the United States, although the Canadian rules and proposed rules are less stringent in nature than SOX.¹⁰² The CSA rules and proposed rules generally envision that the CEO and CFO of publicly listed issuers will publicly certify that they have read certain shareholder disclosure documents, that those documents are accurate, that they acknowledge responsibility for designing disclosure controls and procedures and internal controls over financial reporting and that they have caused certain changes and evaluations to be disclosed. The Board understands that these rules and proposed rules have been in a state of flux, with a variety of amendments, proposed amendments and CSA staff notices having been issued over the past several years.

Although AUI is not a publicly listed corporation, it indicated that it is subject to these requirements because it is the subsidiary of AUGI, a publicly traded corporation. AUI indicated that AUGI provides fiduciary and direct support to AUI, most notably in relation to debt financing in public markets, and AUI's CEO/CFO certification was therefore necessary in order to assist AUI in obtaining financing. Additionally, AUI indicated that the resulting business and

¹⁰⁰ Decision 2005-029, page 8

¹⁰¹ Exhibit 002-01, pages 136, 177, citing Bill 198 (Ontario), proposed Multilateral Instrument (MI) 52-109, MI 52-111, Canadian Securities Administrators (CSA) Staff Notice 52-311, and CSA Staff Notice 52-313 (which confirmed that MI 52-111 will not be implemented and that MI 52-109 was to be expanded to some extent).

¹⁰² Transcript Volume 3, page 539

financial controls and documentation flowing out of AUI's CEO/CFO certification were necessary for sound business management since they involve, in part, CEOs and CFOs personally certifying, amongst other things, that disclosure controls and procedures are in place.

AUI's CEO/CFO certification project began in April 2005 and included the following general phases:

- project scoping;
- business process documentation;
- business process control development;
- business control testing; and
- business control deficiency correction and finalization.

In its 2005-2006 GRA, AUI proposed that a deferral account be established for CEO/CFO certification costs and that the costs be amortized over five years from 2005 through 2009. Additionally, AUI proposed that at its next GRA, the deferral account balance be reconciled with actual costs.

The Board agreed in part with AUI and directed, due to the uncertainty surrounding the timing and magnitude of the costs, that AUI establish a deferral account for 2005 and 2006 forecast costs and that any determination of CEO/CFO certification costs and the amortization of those costs beyond 2006 would be reviewed at AUI's next GRA. For 2005 and 2006, the Board approved amortization of CEO/CFO certification costs of \$264,000 and \$125,000, respectively.

At December 31, 2006, the amortized balance of these costs was \$844,200 and AUI forecast additional costs of \$620,600 for 2007. AUI proposed to amortize \$822,500 of these costs in 2007 and the balance in 2008. The proposed amortization amount for 2007 amounted to an increase of \$697,500 over the \$125,000 approved in Decision 2005-127 for 2006.

AUMA/UCA stated that there did not appear to be any evidence to suggest that the CEO/CFO certification costs included in AUI's deferral account were not prudent. However, AUMA/UCA noted that these costs have aggregated to \$1,853,800 since 2005 and were one of the major cost increases in the 2007 GRA. Consequently, AUMA/UCA submitted that the costs remaining in the 2007 deferral account should be amortized through 2009. AUMA/UCA argued that amortizing the costs in the deferral account over that period would reduce 2007 revenue requirements by \$304,200.

AUI noted that its CEO/CFO certification project was anticipated to be substantially complete by 2007 and any post 2007 costs were expected to be significantly lower than those previously incurred.¹⁰³ AUI considered that the total costs of approximately \$1,850,000 associated with implementing its CEO/CFO certification project were reasonable.

Notwithstanding that it proposed that the balance in its CEO/CFO certification deferral account be amortized over the years 2007 and 2008, AUI was not opposed to amortizing the amount over the five year period ending December 31, 2009, as originally proposed in its 2005-2006 GRA. AUI submitted that amortizing the CEO/CFO certification costs over either term was both consistent with the methodology approved by the Board in AUI's 2005-2006 GRA and would

¹⁰³ AUI Argument, page 28

generally ensure these costs were expensed in a timely manner in accordance with general accounting guidelines while also matching expenses with benefits, particularly if a two year amortization period was selected.

Views of the Board

The Board observes that AUI indicated that it expects its CEO/CFO certification costs to be reduced dramatically, to an estimated level in the range of \$25,000 to a \$50,000 maximum, starting in 2008.¹⁰⁴ The Board approves AUI's reconciliation of its 2005 and 2006 CEO/CFO certification costs for 2005 and 2006 and approves AUI's forecast for those costs in 2007.

The Board notes that AUI was not opposed to amortizing the balance of \$844,200 at December 31, 2006 and the additional forecast amounts of \$620,600 for 2007 through 2009, as recommended by AUMA/UCA. The Board considers that the longer amortization period is reasonable under the circumstances given the amount of costs incurred by AUI. Therefore, the Board directs AUI, in its Refiling, to provide for the amortization of those costs in its CEO/CFO certification cost deferral account uniformly over the period 2007 through 2009 and to file a reconciliation of the forecast 2007 costs with the amounts actually incurred.

5 USAGE FORECASTS

AUI indicated that it had enhanced its method of forecasting customer usage for Rate Classes 1/11 and 2/12 by using historic trend analysis. The enhancement was based on the Board's consideration of trend analysis information in setting AUI's allowed forecasts in AUI's 2005-2006 GRA. For Demand/Commodity Rate Class (3/13) customers, AUI continued to base usage on expected consumption as approved in the 2005-2006 GRA. Similarly, AUI used the 2005-2006 GRA arithmetic average of historical deliveries to forecast consumption for its Irrigation Rate Class (4/14). The usage forecasts are noted below:

Table 4. AUI 2007 Forecast of Customer Usage

Rate Class	GJ per Customer	GJ per Rate Class	Demand
Residential	119.97	5,405,766	
Commercial	631.74	3,953,271	
Rural	168.71	2,136,095	
Large General Service	7621.20	1,281,632	
Commodity/Demand Customers		2,774,811	186,292
Irrigation Pumping Service		92,379	

MGCI considered that AUI proposed usage forecasts represented a substantial change from AUI's methodology approved by the Board in Decision 2005-127.¹⁰⁵ MGCI stated that AUI's method of forecasting customer usage was unreliable, and that AUI did not provide sufficient evidence to fully support the new approach.

MGCI argued that AUI's methodology to calculate usage was not consistent, given that AUI did not use the same length of trend line from rate class to rate class. AUI then "cherry picks" what it

¹⁰⁴ Transcript Volume 3, pages 540-541

¹⁰⁵ Decision 2005-127, page 15

considered to be the most appropriate length of trend line for each rate class based on the "best fit" which AUI determined based on the highest corresponding r-squared value.¹⁰⁶ MGCI noted that a high r-squared value was not necessarily an indication of a causal relationship.¹⁰⁷

MGCI also noted that the r-squared values changed substantially from the Application to the 2007 Forecast Update, simply by changing the base year from 2005 to 2006.¹⁰⁸ MGCI expected that if this methodology was used again in 2008, the length of trend lines for each rate class would likely be different, simply because of changing the anchor year.

MGCI considered that there were several indications that the usage level was leveling off. The 2007 Forecast Update indicated that the usage levels for Commercial customers was higher in 2006 compared to 2005 and 2004, and large general service usage level for 2006 was higher than 2005.

Based on the random nature of selecting the trend lines, and since there was no reliable evidence to suggest that consumption had decreased, MGCI argued that AUI should adopt the 2006 annual average normalized use per customer for residential, commercial, rural, and large general service rate classes for 2007.

AUI stated that the decrease in gas usage was supported by continuing improvements in new home construction, renovations to existing homes resulting in reduced energy consumption and increasing use of higher efficiency furnaces and appliances.¹⁰⁹

AUI noted MGCI's position that the 2007 forecasting methodology had changed substantially from what the Board approved in AUI's 2005-2006 GRA.¹¹⁰ AUI submitted that the methodology had not changed, but had been revised so as to take into account a trend line analysis similar to the one the Board found supported AUI's 2005-2006 forecast.¹¹¹

While MGCI argued that the forecast methodology was not consistently applied, AUI argued that it consistently applied its methodology, which was to determine the best fit r-squared line for each rate class.¹¹²

Views of the Board

The Board has reviewed the methodology used by AUI to calculate the 2007 usage forecasts, and notes that AUI used 3, 4, 5, and 6 years worth of data by rate class, and then used the r-squared value of the trend line to determine which data set best reflected consumption trends¹¹³. AUI then used the best data set and accompanying trend line to predict consumption for 2007. As a result of this methodology, AUI used the three year data set for residential and rural customers, the five year data set for commercial customers and the six year data set for large general service customers.

¹⁰⁶ Transcript Volume 1, page 157, lines 17-23

¹⁰⁷ Transcript Volume 1, page 157, line 24, to page 158, line 1

¹⁰⁸ Transcript Volume 1, page 158 line 2 to page 159, line 21

¹⁰⁹ Exhibit 002-05 BR-AUI-16

¹¹⁰ MGCI Argument, page 2

¹¹¹ Exhibit 002-01, pages 126-128

¹¹² Exhibit 002-01, pages 127-128

¹¹³ On page 62 of the Application Update, AUI indicated that the time period for the 5-year trend was 2001-2005. It appears to the Board that AUI used the 2002-2006 time period in calculating the 5-year r-squared values.

The Board does not agree with AUI's use of a three year data set to determine the 2007 usage forecasts for residential and commercial customers. The Board considers that the three year data set does not appropriately capture the long term trends that are occurring for these customers. Further, using a three year data set does not allow sufficient time for variations in weather or other anomalies to be averaged out. On this basis the Board rejects AUI's 2007 usage forecasts for residential and rural customers.

The Board notes that the usage forecasts for commercial and large general service used five year and six year data sets respectively.¹¹⁴ The Board considers that it is appropriate to use longer terms to determine usage forecasts. It would also be appropriate to determine usage for each rate class using a consistent data set. On this basis the Board considers that it must determine whether a five year or six year data set would be appropriate.

The Board notes the following r-squared values for the five and six year trend analysis as follows:

Table 5. Board Excerpt of Table 13 from Application Update

r-squared	5 Year Trend (%)	6 Year Trend (%)
Residential	90.19	71.93
Commercial	63.75	1.07
Rural	94.61	72.98
Large General Service	86.58	87.28

The Board finds that the five-year trend r-squared values are superior to the six year trend values for all rate classes except large general service. With respect to large general service, the Board notes that the variance in r-square values is very small. Overall the average r-squared values are higher with the five-year trend values than with the six-year trend values, indicating better fit with the underlying data. Given these findings, the Board considers that it would be appropriate for AUI to use a five-year trend analysis in determining usage forecasts.

Therefore the Board directs AUI in the Refiling to use the five-year trend analysis in projecting annual usage forecasts for Residential, Commercial, Rural and Large General Service customers.

6 OPERATING AND ADMINISTRATIVE EXPENSES

6.1 Salary and Wages

AUI determined its proposed 5.5% salary increase for its non-bargaining unit employees using a 4.0% market-based adjustment and three 0.5% increments. The market-based adjustment was based on results from a Mercer Compensation Planning Survey and the three increments were included to account for:

- a) the difference between Alberta CPI and AUI compounded salary increases since January 2002,

¹¹⁴ Application Update, page 62

- b) the general labour supply/demand in Alberta, and
- c) the differences between utility, and oil and gas sector salaries.

The interveners had concerns not only with the proposed 5.5% increase and the underlying Mercer survey, but also with AUI's proposed vacancy rate forecast. The Board will deal with each issue separately.

6.1.1 Salary Increases / Mercer Survey

AUMA/UCA argued that the Mercer Compensation Planning Survey¹¹⁵ (Mercer Report) was unreliable, since the survey had no information related to the size, number of employees or even the industry in which the participating organizations were employed. As a result, it was difficult to determine what weight should be placed on the 4.0% market adjustment without additional information or testimony from Mercer.

AUMA/UCA noted that the Mercer Report already reflected the highest projected salary increases nationally for Alberta and there was no need for further adjustments to the salary level. AUMA/UCA argued that each of three 0.5% salary increments in the report were arbitrary at best and submitted that the Board should limit AUI's proposed salary increase to the 3.5% level approved for ATCO Gas in 2007.

AUI argued that the Mercer Report was a national survey, which included 19 utility companies from across Canada, 11 of which operated in Alberta¹¹⁶ and there was no better objective third party source available to AUI to base its 2007 forecast for salaries and wages.

AUI iterated that it had proposed the first 0.5% adjustment to account for the lag between Alberta CPI and AUI's compounded salary increases since January 2002.¹¹⁷ With respect to the three 0.5% increments, AUI argued that the interveners misinterpreted the Mercer Report when they implied that the report's 4.0% Alberta (all-industry) projected mean salary increase accounted for the three increments, when it did not.

AUI argued that there was no evidence supporting a comparison of remuneration programs for non-bargaining unit employees between ATCO Gas and AUI. Also, AUI noted that interveners overlooked the fact that ATCO Gas' application was based on CPIs of 2.2%, 2.2% and 2.1% for each of 2005, 2006 and 2007.¹¹⁸

Views of the Board

The Board finds that there is no evidence comparing either the history or the remuneration programs for non-bargaining unit employees between ATCO Gas and AUI. The Board further finds that ATCO Gas' application was based on CPIs of 2.2%, 2.2% and 2.1% for each of 2005, 2006 and 2007.¹¹⁹ For these reasons, the Board rejects the intervener submission to limit AUI's proposed salary increase to the 3.5% level approved for ATCO Gas.

¹¹⁵ Exhibit 09-019, Undertaking Response Transcript Volume 1, page 85

¹¹⁶ Exhibit 09-010, Undertaking Response Transcript Volume 1, page 85

¹¹⁷ Exhibit 002-05 BR-AUI-20

¹¹⁸ Decision 2006-004, page 64

¹¹⁹ Decision 2006-004, page 64

With respect to the Mercer Report, the Board notes the submission of AUMA/UCA that it may be difficult to determine what weight should be placed on the survey results without further information. However, noting current Alberta market conditions and the survey results that indicate an Alberta (all-industry) projected mean salary increase of 4.0%, the Board finds that AUI's proposed market based adjustment provides a reasonable starting point for salary adjustments.

Considering that the survey results indicate mean projected salary increases of 4.2% and 5.6% respectively for the utility, oil, gas and petrochemical participants from across Canada, the Board finds the proposed 4.0% market adjustment to be low when viewed as a total salary adjustment. Therefore, the Board rejects AUMA/UCA's submission that there should be no further increases in addition to AUI's market based adjustment.

Considering the low unemployment rate in Alberta, the Board finds it reasonable that a further 0.5% is added to the market adjustment to reflect the tight Alberta labour market. Further, taking into consideration that AUI to some extent is in the same market for labour as the oil and gas, and petrochemical industries, the Board finds the 0.5% increment to account for the difference between the utility, and oil and gas sector salaries to be reasonable.

Considering that:

- the Mercer Report's 5.6% oil, gas and petrochemical projected mean salary increase for 2007 is an all-Provincial result,
- AUI, to some extent, competes for labour in the same market as the oil and gas petrochemical industry,
- the oil, gas and petrochemical industry plays a lead role in the Alberta economy,
- the low unemployment rate continues in Alberta, and
- AUI's need for additional staff to manage customer and system growth as well as workforce demographics.

The Board finds that AUI's proposed 5.5% applied-for salary increase for its non-bargaining unit employees is reasonable and acceptable for the 2007 test-year. Accordingly, the Board finds AUI's adjustment to reflect the lag between Alberta CPI and AUI compounded salaries since January 2002 to be reasonable and necessary. Therefore, the Board approves AUI's 5.5% applied-for salary increase for its non-bargaining unit employees for 2007.

The Board directs AUI in future GRAs, when using surveys such as the Mercer Report, to provide additional information that allows for valid industry comparisons between AUI and other representative utilities. The information should include, but not be limited to, a description of both the market and the industry in which the comparative utilities participate, the size of the comparative utility and the number of employees.

6.1.2 Slippage Vacancy Rate

AUI applied for approval of the salary costs associated with 11.0 new full time equivalents (FTEs).¹²⁰ Of the 11 FTEs that AUI had forecast to hire, three were to start on January 1, 2007

¹²⁰ Exhibits 002-01, pages 134-163 and Tables 32 and 34; and 002-05 BR-AUI-20

and the remaining eight were to start July 1, 2007.¹²¹ Accordingly, AUI had included an offset amount of 3 FTEs in its 2007 salary forecast to account for the fact that the some of the new employees would commence work after January 1, 2007.¹²²

AUMA/UCA argued that, contrary to AUI's forecast,¹²³ of the three FTEs scheduled to start on January 1, 2007, one had not started as of May 11, 2007 and the other two started in April 2007.¹²⁴ Noting that it was still possible for the remaining eight FTEs to commence work by July 1, 2007, AUMA/UCA submitted that the Board should reduce salaries by about \$75,000 or one FTE to reflect the delays in hiring.

Subsequent to a further review, AUMA/UCA¹²⁵ submitted that the Board should reduce salaries by \$150,000 to account for a two FTE-year hiring lag. AUMA/UCA based their findings on the timing of hiring five FTEs that was outlined in AUMA/UCA-AUI-9(e), the hiring of two FTEs between May 11 and August 10, 2007 and the fact that there were still four unfilled positions as of August 10, 2007.

AUI submitted that a reduction in its 2007 forecast was appropriate but noted that AUMA/UCA had failed to account for capitalized salaries. AUI submitted that salary expense should be reduced by \$56,250 and capitalized salary costs should be reduced by \$18,750 (i.e. a reduction of one FTE).

Views of the Board

AUI had agreed with AUMA/UCA's earlier position that a salary expense reduction of one FTE was appropriate.

With respect to the four positions that remained vacant as of August 10, 2007, the Board notes the evidence that:¹²⁶

- one position had been temporarily filled after May 11, 2007 and the expectation was that the position would be filled before year end;
- a second position was being interviewed for on August 10, 2007; and
- the other two positions were being deferred, albeit with the expectation they would be filled in another way.

Given the above, the Board finds AUMA/UCA's recommendation to update the slippage vacancy rate to 2.0 FTEs, to be excessive. However, based on the lack of clarity as to the two positions being deferred, the Board considers that it would be appropriate to increase the slippage rate by 1.5 FTEs. Therefore, the Board directs AUI in its re-filing to reduce salary expense by \$84,375 and capitalized salary costs by \$28,125 to reflect an increase in the slippage vacancy rate by 1.5 FTEs, bringing the approved vacancy rate to 4.5 FTEs.

¹²¹ Exhibit 002-08, AUMA/UCA-AUI-9(c)

¹²² Exhibit 002-01, page 137; and Exhibit 002-08 AUMA/UCA-AUI-11

¹²³ Exhibit 002-08, AUMA/UCA-AUI-9(c)

¹²⁴ Exhibit 002-08, AUMA-UCA-AUI-9(e)

¹²⁵ Transcript Volume 3, pages 543-545

¹²⁶ Transcript Volume 3, pages 543-545

6.1.3 Frictional Vacancy Rate

AUI's forecast included a vacancy rate of 2.3 FTEs to account for vacancies in AUI's existing work force complement.¹²⁷

AUMA/UCA argued that the calculation mixed new hires with vacancies and that AUI's forecast frictional vacancy rate (FTE equivalent) should have represented the number of unfilled budgeted positions that arise at various times because of departures, leave, hiring delays, etc. during the test period. AUMA/UCA calculated a frictional vacancy rate without the new hires included and submitted that the Board should reduce salaries by about \$202,500 to reflect a frictional vacancy rate of 5.0 FTEs.

AUI replied that the intervener's position failed to consider that vacant positions may be eliminated if they are no longer required, and new hires may be a replacement for a vacant position. AUI also argued that the interveners failed to appreciate that it was difficult for AUI to anticipate all the new positions that may be required. AUI's 2007 forecast frictional vacancies of 2.3 FTEs accounted for these two assumptions, as well as the recent downward trend respecting the frictional vacancy rate.¹²⁸

AUI noted that AUMA/UCA had failed to account for capitalized salaries and submitted that if the Board were to accept AUMA/UCA's submission, salary expense and capitalized salary costs should be reduced by \$153,100 and \$49,400 respectively.

Views of the Board

The Board finds that AUI's proposed frictional vacancy rate should represent the number of unfilled budgeted positions respecting AUI's existing employee complement that arise at various times because of matters such as departures, leave and hiring delays.

Taking into consideration the continuing low unemployment rate in Alberta and the difficulties that AUI is experiencing with respect to filling forecast new positions, the Board considers that AUMA/UCA's proposed frictional vacancy rate of 5.0 FTE does not reflect the recent downward trend of 2004, 2005 and 2006. Further, the 5.0 frictional vacancy rate was significantly greater than the 3.9 frictional vacancy rate experienced in 2006,¹²⁹ leading the Board to conclude that AUMA/UCA's proposed vacancy rate may be too high. In contrast, the Board notes the tight Alberta labour market which leads the Board to conclude that AUI's proposed 2.3 frictional vacancy rate is too low.

The Board considers that an appropriate vacancy rate would fall somewhere between the 2.3 FTE and 5.0 FTE frictional vacancy rates proposed by AUI and AUMA/UCA respectively. Given the 2006 FTE frictional vacancy rate of 3.9, the Board considers this to be a more realistic indicator for 2007, given the continued nature of Alberta's employment economy. Therefore the Board directs AUI in its Refiling to reduce total salary expense to reflect a frictional vacancy rate of 3.9 FTEs.

¹²⁷ Exhibit 002-08, AUMA/UCA-AUI-11(a)

¹²⁸ Transcript Volume 1, pages 109-111; and Exhibit 002-08 AUMA/UCA-AUI-11

¹²⁹ AUMA/UCA Argument, page 8

6.2 Short Term Incentive Plan (STIP)

In the Application, AUI forecasted 2007 STIP costs at \$853,200.¹³⁰ The actual STIP costs for 2005 and 2006 were \$345,500 and \$394,100 respectively.¹³¹ The STIP is an element of AUI's overall employee remuneration program that serves as an incentive for employees to set performance objectives related to customer satisfaction, safety, productivity and the environment.

AUI employees are eligible to receive STIP compensation in addition to their base salary if business segment objectives and personal or group objectives are met during the plan year. Business segment objectives are comprised of the following categories: financial integrity, customer satisfaction, safety, and the environment. The personal or group objectives are comprised of the following categories: people, systems and processes, business development, productivity and the environment. General key result areas are specified under each category. The relative weighting of each category depends on whether the employee is an executive (president or vice-president), salaried or in a unionized position. AUI indicated that payouts associated with the achievement by executives of the business segment objectives relating to financial integrity were not included in 2007 forecasts, in keeping with previous Board decisions. No payouts were forecast for the achievement of the financial integrity objectives by non-executives.

AUI indicated that the maximum STIP payout eligibilities are 7% of base earnings for salaried employees and 5% of base earnings for bargaining unit employees. The maximum payout for executive positions was established by the board of directors.

AUMA/UCA noted that the STIP objectives were mutually determined and administered between either AUGI's board of directors and AUI's executives or AUI's executive and AUI's non-bargaining unit staff. AUMA/UCA argued that since AUGI was a profit motivated entity, it would not be surprising if the business development and productivity objectives were driven by net income or operating costs. AUMA/UCA also expressed concern there was the potential for a percentage of the president's, vice president's and salaried employees' STIP to be based on net income or operating expenses.

AUMA/UCA noted that when asked how the AUGI board of directors measures success under the business development and productivity objectives, Mr. Tuele stated that it had not set specific objectives in the areas of development and productivity (at least for the executive of AUI).¹³² AUMA/UCA argued that AUI had not provided the specific parameters by which the AUGI board or senior management administers the STIP, and as such, AUI has not met any acceptable burden of proof. Accordingly, AUMA/UCA submitted that until AUI had clearly demonstrated that customers only bear the costs of those objectives or parameters that benefit customers, the Board should maintain the 55% reduction to STIP as approved in Decision 2005-127.

AUI noted that interveners had taken issue with AUI's forecast STIP and argued that AUI had excluded the objectives relating to financial integrity. AUI argued that there was no evidence on the record, other than that regarding the financial integrity component of the executive STIP, to

¹³⁰ Exhibit 002-01, page 167. See also Exhibit 002-08, AUMA/UCA-AUI-10(b)

¹³¹ BR-AUI-19(a)

¹³² Transcript Volume 1, page 96

suggest that either net income or operating cost was the driving force behind any of the STIP components.¹³³

AUI argued that its STIP was flexible, as it permitted executives and employees to set individual goals within defined areas that were to the benefit of customers.¹³⁴ AUI submitted that the interveners' recommendation should be dismissed since there had been no evidence adduced that supported their determination.¹³⁵

AUI submitted that the Board should approve the portion of salary costs attributable to STIP as forecast in the Application and asserted that these portions were not to the benefit of shareholders but instead were to the benefit of AUI's ratepayers. However, should the board accept the interveners' position, AUI suggested that any reduction should be limited in scope to the executive STIP. It also argued that the most reasonable approach would be to assume that AUI's executive set their individual goals equally among all the individual goal categories. Since business development and productivity are only two of six individual goal categories, the maximum reduction should be two-sixths (or 1/3) of the overall weighting related to individual goals.

Views of the Board

The Board notes that in Decision 2005-127, it addressed AUI's proposal for STIP payments, and stated:

...While the Board recognizes that employees are a valued resource, especially for a small utility such as AUI, the Board denies STIP compensation with targets that are to the benefit of shareholders (financial targets with net income weighted at 30% and operating expenses at 25%)....¹³⁶

The Board considers that where the utility has demonstrated that the benefits will ultimately add to the efficiency of the utility, there is merit to the applicable portion of the STIP being included in revenue requirement. However, where the benefit is increased return or other benefits to shareholders, the Board does not view funding that portion of the STIP through rates to be appropriate. This is consistent with previous Board decisions.

The Board considers that any STIP funding to be included in the approved revenue requirement for the 2007 test year should not include targets that are to the benefit of AUI's shareholders. In order to warrant inclusion in the revenue requirement, STIP targets, including those relating to executive compensation, must be sufficiently focused on issues of benefit to customers.

Having reviewed the evidence, the Board notes the position of the AUMA/UCA and considers that the individual component key result areas of "productivity" and "business development" may serve to benefit shareholders. The Board is not persuaded that the achievement of targets in the key result areas of "productivity" and "business development," particularly at the level of individual executive goals, will necessarily and consistently translate to reduced customer costs

¹³³ Transcript Volume 1, pages 90-106

¹³⁴ Transcript Volume 1, pages 90-106

¹³⁵ Exhibits 002-01 pages 164-166; 002-08 AUMA/UCA-AUI-10; and Transcript Volume 1, pages 90-106

¹³⁶ Decision 2005-127, page 28

that will ultimately be reflected in future utility rates. On this basis, the Board considers that it would be appropriate to reduce AUI's STIP.

The Board agrees with AUI that a reasonable approach to reduce STIP is to limit the reduction to AUI's executive STIP program. Since the executive STIP program contains six individual goal categories, of which two are "business development" and "productivity", the Board considers that the maximum that should be disallowed under this approach would be two-sixths (or 1/3) of the overall weighting relating to individual goals.

Therefore the Board directs AUI in its refiling 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).¹³⁷ 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).¹³⁸

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.

In addition, the Board directs AUI in the Refiling to provide an updated table similar to table in AUMA/UCA-AUI-10(b) that illustrates the changes to STIP.

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.¹³⁹ 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.

¹³⁷ President STIP: 50% of (40% Financial Integrity) + 50% of 1/3 (individual goals) = 36.67%

¹³⁸ Vice-President STIP: 40% of (40% Financial Integrity) + 60% of 1/3 (individual goals) = 36.0%

¹³⁹ Exhibit 002-08-09, AUMA/UCA-AUI-10(a) attachment, page 15

6.3 Vehicle Expense

AUI sought Board approval of 2007 vehicle costs totaling \$1,056,500. Interveners raised concerns regarding the vehicle repair portion of the forecast.

The CCA argued that AUI's forecast of \$200,000 for vehicle repairs was 100% greater than 2006 approved costs and \$40,800 greater than 2006 actual vehicle repair costs. CCA noted that average repair costs per vehicle had increased by 46% in 2006 and were forecast to increase a further 19% in 2007. CCA argued that AUI had provided no evidence to support the 19% increase in average repair costs in 2007. CCA submitted that the Board should reduce AUI's forecast vehicle expenses by \$28,600.

AUI responded that the increase in budgeted vehicle repair costs reflected anticipated increases in third party service charges to perform vehicle maintenance.¹⁴⁰ Further, AUI argued that the CCA failed to provide justification for using a 2% inflation rate. AUI submitted that a 4.5% inflation rate should be used if the Board were to accept CCA's position.

Views of the Board

The Board acknowledges that the forecast 19% increase in average repair costs per vehicle may appear excessive when added to the 46% increase which AUI incurred in 2006. The Board notes that interveners did not argue that AUI's 2006 vehicle repair costs were unreasonable, only that the 19% increase in average repair costs was unreasonable.

The Board acknowledges AUI's explanation that vehicle repair costs are directly tied to labour costs. Taking into consideration the significant increase in "vehicle allowance and mileage"¹⁴¹ and the increase in third party maintenance costs, the Board finds the increase in 2006 average vehicle costs to be reasonable.

Further, given the current economic conditions in Alberta and AUI's increased manpower complement and number of vehicles, the Board finds it reasonable to expect that vehicle allowance and mileage would be comparable to, if not higher than, 2006 levels.

Based on these findings the Board concludes that AUI's forecast vehicle expenses are reasonable for the 2007 test period. Therefore the Board approves AUI's forecast vehicle expenditures of \$1,056,500 for 2007.

6.4 Maintenance Contracts

AUI's 2007 forecast maintenance contracts expense total was \$389,700. The interveners considered that AUI had under spent its 2006 approved amount for maintenance contracts by \$73,900.

CCA adduced that AUI's under spending with respect to 2006 approved maintenance contracts was the product of exchange rate gains and contract work that was not undertaken. While exchange rate gains or losses were understandable, CCA submitted that the Board should reduce AUI's forecast by \$26,600 to account for unspent 2006 approved expenditures.¹⁴²

¹⁴⁰ Exhibit 002-01, page 169

¹⁴¹ BR-AUI-19, Table 37 (Updated)

¹⁴² Transcript Volume 3, pages 488-489

AUI argued that its 2007 forecast was lower than the 2006 approved costs because the majority of AUI's service contracts were paid in US dollars. As well, AUI argued that the 2007 forecast was greater than 2006 actual costs because of an increased number of users on some of the service contracts and increased maintenance costs due to aging equipment and software.¹⁴³

Views of the Board

The Board finds that AUI under spent approximately \$74,000 or 18% of the 2006 allowed maintenance expenses, of which \$26,600 is related to AS400 FIS expenditures.

While the Board notes that AS400 FIS expenditures are annual maintenance payments made by AUI to its vendors, the Board finds that approximately only half of the allowed AS400 FIS expenditures for 2005 and 2006 were actually spent.¹⁴⁴ This over-forecasting by AUI is of concern to the Board, and leads the Board to consider that it would be appropriate to reduce the proposed forecast amounts for 2007. Further, the Board notes that the reduction proposed by the CCA appears reasonable given that AUI has under spent the approved amount for AS400 FIS expenditures in both 2005 and 2006.

Therefore, the Board directs AUI in its Refiling to reduce its maintenance contract expense forecast by \$26,600.

6.5 Audit Fees

AUI's 2007 audit fees forecast included \$78,000 associated with GUA audits in 2005 and 2006.¹⁴⁵

AUMA/UCA suggested that GUA audit costs were no different than any other costs that increased, decreased, appeared or disappeared. Accordingly, the AUMA/UCA submitted that the Board should not allow AUI retroactive recovery of these costs.

AUI argued that its rationale for including the retroactive audit fees in its forecast was that the audits were at the direction of the Board and as a result AUI had no control over the audits. AUI argued further that it had incurred GUA audit costs as a matter of regulation and could not have foreseen whether it would be subject to a GUA audit. Addressing the issue of unanticipated regulatory audit costs, AUI submitted that the Board should direct AUI to set up a standing deferral account and that account balances and their disposition should be addressed in future GRAs.

Views of the Board

The Board rejects AUMA/UCA's submission that the GUA audit costs are no different from any other costs that increase, decrease, appear or disappear. GUA audit costs are required by law, under Part 4 Division 2 of the *Code of Conduct Regulation*.¹⁴⁶ The Board acknowledges that

¹⁴³ Exhibits 002-01, page 173; 002-06-01 Schedule 2.5; 002-09 CCA-AUI-31; and Transcript Volume 3, pages 488-489

¹⁴⁴ Transcript Volume 3, page 488; BR-AUI-19, Table 42 (updated)

¹⁴⁵ Exhibits 002-01, pages 122 and 176-177; 002-06-01 Schedule 2.5; 002-05 BR-AUI-19 and 25; 002-08 AUMA/UCA-AUI-15; 002-09 CCA-AUI-24; and Transcript Volume 1, page 123 and Transcript Volume 3, page 480

¹⁴⁶ AR 183/2003

GUA audit costs are difficult to forecast and considers that they should be approved for inclusion in AUI's forecast.

Accordingly, the Board directs AUI in the Refiling to include its 2005 and 2006 GUA audit costs associated as part of AUI's deferred regulatory costs. The Board further directs AUI in its Refiling to provide a reconciliation of its 2005 and 2006 GUA audit costs setting out the details of amounts forecast and amounts actually incurred and to reflect the increased amortization of deferred regulatory costs resulting from the inclusion of these GUA audit costs. Additionally, the Board directs AUI, in its Refiling and in future GRAs, to identify and reconcile all costs associated with annual GUA audits.

6.6 Material, Contractor and Other

AUI's 2007 forecast related to material, contractor and other expenses of \$1,674,300 included completing the 2006 deferred leak surveys and related work. With respect to the 2006 approved totals, the following table illustrates the categories of costs that interveners took issue with due to AUI's under spending of forecast amounts.

Table 6. Material, Contractor & Other; 2006 Allowed (\$), Actual (\$) and Variance (\$)

Description	2006 Allowed (\$)	2006 Actual (\$)	Variance (\$)
Leak Survey	153,200	43,000	110,200
Lowering High Pressure Lines	150,000	60,000	90,000
Pipeline Maintenance	560,100	367,000	193,100
General Operating	109,700	51,500	58,200

Intervenors argued that AUI's 2007 forecast of \$175,800 for leak surveys included 2006 deferred survey costs. The Board should reduce AUI's 2007 leak survey costs by \$110,000 to ensure that customers do not pay twice for these services.

Notwithstanding AUI's 2007 forecast expenditures of \$47,800 related to the lowering of high pressure lines, the CCA also submitted that the Board should direct AUI to reflect the \$90,000 unspent amount in AUI's material, contractor and other expense forecast.

Given the 2006 variances and the lack of detail respecting the 2007 pipeline maintenance costs, intervenors argued that it was possible that some of AUI's 2006 deferred expenses were included in the 2007 pipeline maintenance forecast. Intervenors submitted that the Board should reduce AUI's 2007 pipeline maintenance expenses with CCA recommending a reduction of \$96,550, and AUMA/UCA recommending a \$100,000 reduction.

With respect to AUI's forecast general operating expenditures, the CCA argued that given the magnitude and AUI's vagueness regarding the \$58,200 variance, the Board should reduce AUI's forecast budget amount by \$29,100.

With respect to the total material, contract and other costs, AUI argued that the variance was only 20% and the following three factors were major contributors to that variance:

- portions of 2006 actual costs related to material, contractor and other expenses were included in AUI's inter-affiliate charges for profit;

- because of delays in commencing the work and a shortage of contractors, AUI did not complete all of its forecast leak surveys; and
- a reduction in other pipeline maintenance that arose because of
 - a. the deferred leak surveys, and
 - b. a general reduction in leak incidents that resulted from the mild 2005-2006 winter.¹⁴⁷

Accordingly, AUI suggested that its 2006 actual costs for material, contractor and other expenses were approximately 20% lower than the Board allowed amount versus the 29% cited by the CCA.

AUI submitted that the fixed forward test year concept was premised upon discretion and argued that it should not incur penalties in future years when it had clearly demonstrated an intention and desire to complete allowed expenditures. AUI submitted that the Board was therefore faced with determining the prudence of forecast costs in the applied for test year and not, in hindsight, assessing the prudence of previously approved costs.¹⁴⁸

Considering that its 2006 actual expenditures for material, contractor and other expenses were 20% lower than forecast, AUI reasoned that it had historically demonstrated a reasonable ability to forecast and submitted that the Board should approve its forecast expenditures for material, contractor and other as filed.

Views of the Board

The Board acknowledges the concerns of interveners with respect to specific categories of AUI's 2006 allowed material, contractor, and other expense forecast.

A comparison of actual expenditures to previously approved allowed totals is one measure of a utility's ability to forecast. However, while AUI argued that 2006 costs were 20% lower than forecast, which may be a reasonable forecast, the Board notes the concerns of the CCA that costs related to previously approved work are being requested again in this Application. In cases where a utility has exhibited a material level of under-spending of prior forecast amounts, the Board has considered the reasonableness of current forecasts in this context and applied downward adjustments.

The Board finds the majority of the increase in staff in 2006 was to keep up with the increased level of capital projects and also notes that because of a shift of existing resources to capital work, the expense component of salary costs decreased.¹⁴⁹ Further, when asked why 2006 general operating expenses were less than forecast, AUI's witness indicated:

I guess some of the activities that we did in 2007, because it was such an **aggressive year from a capital perspective**, maybe – I think part of the answer is probably that we spent more time on capital projects than we may have spent in a normal year and that may have taken away from some of our requirements or expectations in the area of expense ...¹⁵⁰

Some of the concerns relating to under-spending of prior allowed costs, are that the utility might recover deferred costs twice:

¹⁴⁷ Exhibit 002-05 BR-AUI-19, page 15

¹⁴⁸ Section 40 of the GUA

¹⁴⁹ BR-AUI-19, page 5

¹⁵⁰ Transcript Volume 1, page 128 (emphasis added)

- once through the approved but under-spent O&M forecast used to set test-year rates; and
- once through the return and depreciation in future year's rates.

The Board recognizes that AUI may have had little control respecting the variances that arose. Variances arose because of a late start and a shortage of contractors.¹⁵¹ Other variances arose because of a general reduction in leak incidents due to a mild winter¹⁵², and because of the discretionary nature of the type of maintenance.¹⁵³

Based on all the factors before it, the Board considers that it would be appropriate to reduce AUI's forecast for material, contractor and other costs to provide a more reasonable forecast for 2007, given the variance in forecast vs. actual expenditures for 2006. At the same time, the Board recognizes factors beyond the company's control such as weather, the tight labour market and prioritizing of capital related work in 2006. Therefore the Board has determined that the following forecast amounts should be reduced by 50% of their respective 2006 variances, as set out in the table below:

Table 7. Board Approved Material, Contractor & Other Expenses

Description	2007 Forecast (\$)	2007 Board Reduction (\$)	2007 Board Approved (\$)
Leak Survey	175,800	55,100	120,700
Lowering High Pressure Lines	47,800	45,000	2,800
Pipeline Maintenance	487,000	96,550	390,450
General Operating	113,500	29,100	84,400

Therefore the Board directs AUI in its Refiling to reduce its leak survey forecast by \$55,100, reduce its lowering of high pressure lines forecast by \$45,000, reduce its pipeline maintenance forecast by \$96,550, and to reduce its general operating forecast by \$29,100; for a total reduction of \$225,750 to AUI's 2007 material, contractor and other O&M expense forecast.

6.7 Sponsorship of Community Events

AUI's customer communication forecast included \$20,000 for the sponsorship of community events.

The CCA argued that the Board should deny the community events expense amounts as the Board's direction was clear; such costs were not allowed to be recovered through a utility's revenue requirement.¹⁵⁴

AUI argued that the forecast expenditures benefited the communities in which AUI operated because smaller communities do not have access to corporate sponsorship. Additionally, AUI argued that the expenditures were absent any political and specific charitable affiliation, and the

¹⁵¹ BR-AUI-19, page 15

¹⁵² BR-AUI-19, page 15

¹⁵³ Transcript Volume 3, pages 494-496

¹⁵⁴ Decision 2005-127, page 29

criteria that AUI used, ensured that the sponsored events generally promoted education, safety, health or environmental stewardship.¹⁵⁵

Views of the Board

In Decision 2005-127, the Board considered charitable donations and sponsorships and quoted from Decision 2004-067:¹⁵⁶

As the Board has recently held in Decision 2003-106 and previously in Decision U97065, the Board considers that neither sponsorships nor donations (charitable or political) should be included in a utility's revenue requirement. The Board recognizes that ratepayers may not desire to support the same organizations as utility management or shareholders support. Therefore, the Board considers it inappropriate for ratepayers to bear such costs and considers that all donations and sponsorships should remain as a shareholder expense. As AE suggests, this approach has been consistently applied by the Board to the utilities it regulates for a number of years.¹⁵⁷

Although the community expense item is small, the Board does not consider it appropriate for these costs to be borne by ratepayers. The Board continues to hold the view that sponsorship of community events should not be included in revenue requirement. Therefore the Board directs AUI in its compliance filing to reflect a reduction of \$20,000.

7 INTER-AFFILIATE CHARGES – SHARED COSTS

AUI forecasts total inter-affiliate charges of \$1,858,510 in 2007. These charges relate to direct services and fiduciary services provided to AUI by its indirect owner, AltaGas Utilities Group Inc. (AUGI). AUI indicated that direct services support business or administrative operations that would otherwise be provided by AUI or contracted to a third-party. It also indicated that fiduciary services relate to accessing capital markets and were not duplicated in AUI.¹⁵⁸

¹⁵⁵ Exhibits 002-01, page 174; and 002-05 BR-AUI-22

¹⁵⁶ Decision 2004-067 – EPCOR Distribution Inc. 2004 Distribution Tariff Application Part B: 2004 Final Distribution Tariff (Application 1306821) (Released: Aug 13, 2004) page 50

¹⁵⁷ Decision 2005-127, pages 28-29

¹⁵⁸ Exhibit 002-01, page 200

AUI provided the following table in the Application, highlighting the increased costs:¹⁵⁹

Table 8. AUI Forecast of Shared Costs

	2005 Actual (\$)	2006 Allowed (\$)	2007 Forecast (\$)
DIRECT SERVICES			
Control, Finance, Accounting & Shareholder Services	6,073	6,377	9,112
Tax	12,757	13,395	1,303
Human Resources	23,062	24,215	20,458
Treasury	91,081	95,635	165,711
Corporate Secretary	15,210	15,971	39,011
Legal & Regulatory	7,605	7,985	67,032
Insurance	7,605	7,985	98,852
Information Technology	6,072	6,375	-
Executive & Strategy	-	-	100,072
Internal Audit	-	-	22,363
AUI Directors' Fees	80,913	84,959	72,368
Subtotal Direct	250,378	262,897	596,282
FIDUCIARY SERVICES			
Control, Finance, Accounting & Shareholder Services	26,049	27,352	112,333
Third Party Control, Finance, Accounting & Shareholder Costs (2006 Trustee Fees, AGM, Annual)	47,282	48,465	493,744
Tax	6,841	7,183	2,962
Human Resources	12,367	12,985	4,382
Treasury	26,049	27,351	36,022
Corporate Secretary	-	-	19,621
Legal & Regulatory	73,885	77,579	580
Insurance (including Third Party costs)	-	-	127,573
Executive & Strategy	16,314	17,129	328,203
Financial Analysis & Planning	26,049	27,351	42,870
EH&S	1,369	1,438	8,454
Information Technology	8,156	8,564	35,167
Internal Audit	-	-	1,420
AUGI Directors' Fees	-	-	48,897
Subtotal Fiduciary	244,361	255,397	1,262,228
Total Fiduciary and Direct Services	494,739	518,294	1,858,510

AUI indicated that charges for direct services to be provided by AUGI to AUI in 2007 were determined in the following manner:

- a) AUGI and AUI management agreed on the types and level of service required by AUI;
- b) AUGI and AUI management agreed on the estimates of labour time required to provide the required direct services; and
- c) AUGI management used the estimate of labour time and the cost of that labour to determine the fully-burdened (for benefits and administrative support) cost of providing the required services.¹⁶⁰

¹⁵⁹ Exhibit 002-01, page 212, Table 57

¹⁶⁰ Exhibit 002-01, page 204

AUI indicated that charges for fiduciary services to be provided by AUGI to AUI in 2007 were determined in the following manner:¹⁶¹

- a) AUGI management categorized the estimates of labour time required to provide fiduciary services to support all of AUGI's investments in the operating businesses of AUI, Heritage Gas and Inuvik Gas.
- b) AUGI management used the estimate of labour time and the cost of that labour (fully-burdened for benefits and administrative support) plus the estimate of the cost of third party services required, to determine the cost of providing the required fiduciary services.
- c) The total cost to provide fiduciary services was allocated to AUI based on its proportion of the total assets of the operating businesses owned by AUGI, as published in the most recently available audited financial statements that being the 2005 audited financial statements (91.40% is used for 2007).

AUI indicated that to assist in assessing the fairness and reasonableness of the inter-affiliate charges from AUGI for shared costs, it engaged KPMG LLP to perform an independent review of the types, levels and costs of the services provided by AUGI to AUI.¹⁶²

In the Application, AUI provided Table 56, which showed the cost increases reflected in the 2007 forecast, as shown below:

¹⁶¹ Exhibit 002-01, pages 204, 205

¹⁶² Exhibit 002-01, page 202 and Tab 14

Table 9. Inter-Affiliate Charges for Shared Costs Continuity 2006-2007

2006 Charges to AUI	(\$)			\$518,294
	Time Changes	Change Allocation from 21.45% to 91.40%	Cost Increases	
Employee Costs				
Direct Services Not Included in 2006				
Executive, Corporate Secretary, Internal, Audit, Other	122,433	-	-	122,433
Direct Costs Undercharged in 2006				
Treasury	63,757	-	6,319	70,076
Insurance and Other	59,810	-	19,002	78,812
Legal and Regulatory	15,970	-	46,095	62,065
	139,537		71,416	210,953
		-		
Fiduciary Costs	(63,234)	421,030		357,796
Total Employee Costs Changes	198,736	421,030	71,416	691,182
Third Party Costs				
Third Party Costs Not Included in 2006				
Corporate Insurance		-	122,184	122,184
Shareholder Communication:				
-wire services and French translation		-	91,643	91,643
-investor relations activities		-	70,298	70,298
Accounting Consulting		-	46,429	46,429
Information Technology Systems		-	32,674	32,674
AUGI Directors Fees		-	48,897	48,897
Other		-	8,957	8,957
			421,082	421,082
Costs Understated in 2006				
Audit Fees		87,433	13,545	100,978
External Legal Fees		29,377	7,804	37,181
Stock Exchange Fees		26,352	401	26,753
Other – Shareholder Communication and Regulatory Compliance		68,381	(5,341)	63,040
		211,543	16,409	227,952
Total Third Party Cost Changes		211,543	437,491	649,034
Total Change from 2006 to 2007	198,736	632,573	508,907	1,340,216
2007 charges to AUI (2006 charges + Changes)				\$1,858,510

AUMA/UCA noted that for 2007, AUGI and AUI entered into a new Administrative Services Agreement (ASA)¹⁶³ for shared services, consisting of direct services and fiduciary services provided by AUGI.

¹⁶³ Exhibit 002-01, Tab 15

AUMA/UCA summarized the increases in shared services costs over the 2006 allowed amounts as follows:

Table 10. AUMA/UCA Summarization of Shared Service Costs

	2006 Allowed	2007 Forecast	Increase
Direct Services	\$262,897	\$596,282	+126%
Fiduciary Services	\$255,397	\$1,262,228	+394%
Total	\$518,294	\$1,858,510	+258%

AUMA/UCA considered that the substantial increase in shared services was the result of the share transfer transaction¹⁶⁴ (Transaction) and constituted harm to customers. Further, in Decision 2005-112,¹⁶⁵ the Board stated that its approval of the Transaction was granted with the intention and upon the condition that any potential harm to AUI's customers would be adequately tested and addressed in AUI's next GRA and in any debenture application that was filed.¹⁶⁶ As such, Decisions 2005-112 and 2006-049 should be used to provide guidance with respect to the appropriate treatment of the significant increases in shared services forecast for 2007.

AUMA/UCA noted that as a result of the Transaction, AUI has gone from a shared services arrangement with AltaGas Income Trust (AIT) to a new arrangement with AUGI where it was charged 91.4% of the costs incurred by AUGI with the remaining costs being charged to Inuvik Gas Limited and Heritage Gas Limited. This new arrangement resulted in AUI bearing the majority of direct and fiduciary costs which were substantially higher than the previous arrangement with AIT. AUMA/UCA argued that this constituted a breach of AltaGas Utility Holdings Inc. (AUHI) assurances during the Transaction proceeding, that the share transfer would have no adverse impacts on the customers of AUI.

AUMA/UCA submitted that it was inappropriate for the Board to place any weight on the after-the-fact evidence contained in AUMA/UCA-AUI-16(a) because it did not comport with the long-standing treatment by AltaGas Services Inc. (ASI)/AIT of shared service costs which were typically treated as overheads. There was no evidence to suggest that ASI/AIT fiduciary costs would have been materially less absent ownership of AUI.

AUMA/UCA argued that the pro-forma analyses for 2006 provided in AUMA/UCA-AUI-16(a) should be rejected because the cost increases appeared unreasonable and were not reflective of AIT's prior policy of treating these costs as overheads. AUMA/UCA also argued that the Board should place no weight on AUMA/UCA-AUI-16(a) because it was filed late in the proceeding, approximately one week before commencement of the hearing. AUI argued that AUMA/UCA had an opportunity to test AUMA/UCA-AUI-16(a) in cross-examination at the hearing, that AUMA/UCA took no issue in advance of or at the hearing to the timing of the filing, and that

¹⁶⁴ The Transaction was approved in Decision 2005-112, following a request by AUHI (an indirect subsidiary of AIT) for approval to transfer 100% of the outstanding shares in the capital stock of AUHI from AltaGas Holding Limited Partnership No. 1 to AUGI, as part of the larger Transaction, described more fully in Decision 2005-112. The Transaction would ultimately result in the spinoff of AUI into a subsidiary of AUGI, which is a publicly traded company.

¹⁶⁵ Decision 2005-112 – AltaGas Utility Holdings Inc. Request for Approval of Share Transfer (Application 1408750) (Released: October 14, 2005)

¹⁶⁶ Decision 2005-112, pages 5 and 9

AUMA/UCA itself had requested the information, which was provided by AUI via AIT, and that it should be considered.

In BR-AUI-27(b), AUI provided information supporting its submission that it had been subsidized over the last eight years. AUMA/UCA considered that the subsidy amount in 2006 was based on a comparison of AUGI fully allocated costs versus the shared costs payable under the AIT structure, which did not appear to be fully allocated. AUMA/UCA stated that this was an apples and oranges comparison, and that the Board should not give any weight to the analyses in BR-AUI-27(b).

AUI stated that the inter-affiliate shared charges relate to direct and fiduciary services provided by AUGI and that:

The KPMG review concluded that the direct and fiduciary services provided by AUGI to AUI are required and that the method of allocating the costs of those services to AUI for 2007 is fair and reasonable. Furthermore, the costs that AUI would incur to provide these services internally or to receive them through an outsourcing arrangement would be higher than the costs allocated from AUGI. AUI management has concluded, from these findings and its own review that the services received from AUGI are required by AUI and are provided at fair and reasonable costs. The costs charged by AUGI to AUI are included as costs of service in this Application.¹⁶⁷

AUI argued that the interveners' arguments that AUI's 2007 forecast for inter-affiliate charges were the direct result of the Transaction, that AUI's forecast should be rejected and that the Board should approve AUI's 2006 allowed amount adjusted for inflation¹⁶⁸ were flawed because they relied on three fallacies:

- Failing to seek recovery of historically incurred costs was grounds to deny a gas utility from recovering otherwise prudently incurred costs in the future;
- Cost of service regulation was premised on historical costs and not prudent costs; and
- The standard to be applied in determining a gas utility's revenue requirement was the "no harm" standard.

AUI argued that the increase in inter-affiliate costs over prior allowed costs was due to a historic lack of diligence by AUI's parent in determining what services were actually provided and the actual costs of those services over the period from 1999 to 2006.¹⁶⁹ AUI argued that the methodology employed had not changed, and erroneous inputs into the cost calculation had been corrected for AUI's 2007 forecast.¹⁷⁰

AUI noted that cost of service regulation and the principle of fixed forward test year was forward looking and was based on the assessment and determination of prudent costs for the test year in question.¹⁷¹ Consideration of historical costs was only relevant to the extent that it assisted the

¹⁶⁷ Application, pages 203-204

¹⁶⁸ AUMA/UCA Argument, page 26

¹⁶⁹ Application, page 201

¹⁷⁰ Exhibits 002-01 pages 200-201 and 208-212; 002-05 BR-AUI-27; 002-15 July 30, 2007 letter from AltaGas; and Transcript Volume 2, pages 236-242, 288-289, 339-340 and 368-369. See also AUI Argument, pages 33-34.

¹⁷¹ Part 4 of the GUA – notably section 40 and section 4 of the Regulation.

Board in assessing AUI's forecasting ability, and was irrelevant to the determination of prudent costs for inclusion in the applied for test year.¹⁷²

AUI submitted that the “no-harm” test was the standard to be applied in protecting the public interest, and was limited to the sale or transfer of utility assets under sections 26 or 27 of the GUA.¹⁷³ AUI further submitted that the no-harm standard had no application to the Board's determination of utility rates. AUI argued that the Board is obligated to apply the express legislative and legal standard of “just and reasonable” in determining rates of a gas utility.¹⁷⁴

AUI also argued that it had confirmed that the Transaction resulted in no impact to the costs included in its forecast for the 2007 test year and that no direct or indirect costs of the Transaction itself were borne by AUI ratepayers.¹⁷⁵

In Reply, AUI further argued that the no-harm standard would in any event be met based on the evidence. AUI argued that the actual inter-affiliate services received had not substantially changed since the Transaction, but instead a historic and propagating error in the application of the methodology had been corrected.¹⁷⁶ AUI argued that the substantial increase in AUI's 2007 forecast for inter-affiliate charges was not directly or indirectly related to the Transaction. It argued that there was no causal connection and that no harm had occurred to its ratepayers as a result of the Transaction. It argued that the opposite was true, that AUI's ratepayers were arguably paying \$640,000 less than they would have paid had the Transaction never occurred.¹⁷⁷

AUMA/UCA noted that STIP amounts of \$123,000 identified in the KPMG review were included in the shared service charges to AUI. Noting Decision 2005-127,¹⁷⁸ AUMA/UCA considered that the entire amount of business segment objectives and the shareholder value component of the personal or group objectives were to the benefit of shareholders. Accordingly, AUMA/UCA submitted that the following conservative percentages of STIP should be deemed to be shareholder-related and not allowed in revenue requirements, should the Board consider any increase in affiliate shared services costs beyond inflation was appropriate:

Table 11. AUMA/UCA Recommendation of STIP Percentages Deemed to be Shareholder-Related

President and CEO	75%
CFO and CS	67%
Director	50%
Manager	46%
Other	42%

Although KPMG considered that the Board may determine that including shareholder-related incentive compensation costs related to AUGI employees may not be fair and reasonable, AUI was of the opinion that such costs should nevertheless be allowed in the forecast. It submitted

¹⁷² Supra note 85 Decision 2006-004 at pages 49-50. See also AUI Argument, page 10.

¹⁷³ Decision 2007-005 – ATCO Gas South - Carbon Facilities - Part 1 Module - Jurisdiction (2005/2006 Carbon Storage Plan) (Application 1357130) (Released: February 5, 2007), page 33

¹⁷⁴ AUI Argument, pages 3-7

¹⁷⁵ AUI Argument, page 48, citing Transcript Volume 3, pages 560-561

¹⁷⁶ AUI Reply Argument, pages 39-40, citing Exhibit 002-001 pages 201, 204-208; and Transcript Volume 2, pages 236, 239 and 291, and AUI Argument at pages 33-34

¹⁷⁷ AUI Reply Argument, page 39, citing Exhibits 002-15 and 002-01 page 211

¹⁷⁸ Decision 2005-127, page 28

that AUGI was its own corporate entity, for the most part not unlike any other corporation from which AUI might receive a service. It asserted that AUI should be indifferent to the possibility that employees of a corporation that provide a service to it might receive compensation tied to the interests of the shareholders of that corporation. The concern of AUI should be that the overall cost of the service is fair, reasonable and reflects market conditions. Since AUGI does not directly own or operate assets used in the provision of a utility service to the public in Alberta, AUI considered that AUGI's labour costs should not be subject to the same tests as those of AUI, except to the extent necessary to demonstrate that the costs are prudent on an overall basis.¹⁷⁹

Views of the Board

In Decision 2005-112, the Board considered an application by AUHI¹⁸⁰ for Board approval of the Transaction pursuant to section 27 of the GUA. In that decision, the Board noted the following concerns with respect to the Transaction, and AUHI's response:

The Customer Groups, while not opposed to the Application noted that there are a number of issues underlying the Transaction that may impact customers on a cost and/or service basis. Areas of concern identified by interveners included:

- Debt Financing
- Affiliate or Shared Services Costs
- New or Undisclosed Contractual Obligations of AUHI
- Changes in the Risk Profile of AUHI

In a letter dated September 6, 2005, Customer Groups stated that "customers are concerned there may be negative ramifications that cannot be explored until the next General Rate Application and/or Debenture Application of AltaGas Utilities Inc."⁴ The Customer Groups concluded that "all potential consequences for AUI arising from the transaction underpinning the application must be thoroughly tested in the next AUI GRA and/or debenture application, and if there are demonstrable cost increases as a result of the new structure, customers anticipate that these would be held to be shareholder costs."⁵ AUHI supported deferring a detailed examination of the ramifications of the Transaction to AUI's next GRA.¹⁸¹

⁴ Bryan & Company Letter on Behalf of Customer Groups, September 6, 2005, p.2

⁵ Bryan & Company Letter on Behalf of Customer Groups, September 6, 2005, p.2

The Board also made the following statements in Decision 2005-112:

Before determining the appropriate proceedings to assess all ramifications from the Transaction, the Board must determine the test that should be applied. The Board continues to be of the view that the "no harm test" is an appropriate means of ensuring that the Board's public interest mandate is met, while customers of AUI are, to the maximum extent possible, protected against any negative ramifications arising from the Transaction.¹⁸²

¹⁷⁹ Exhibit 002-01, page 203

¹⁸⁰ AUI is a direct, wholly-owned subsidiary of AUHI, and AUHI is a direct, wholly-owned subsidiary of AUGI. Exhibit 002-10-03, attachment to MGCI-AUI 4(b), page 5.

¹⁸¹ Decision 2005-112, page 5

¹⁸² Decision 2005-112, page 4

...

The “no harm” test is intended to balance the potential positive and negative impacts of the proposed Transaction on customers to ensure that they are at least no worse off after the Transaction.¹⁸³

...

[t]he Board is of the view that it would be appropriate for all ramifications arising from the Transaction to be thoroughly explored and tested by all parties in AUI’s next GRA and in any debenture application that is filed, provided that the matters to be explored in the debenture application will be limited to financial matters. Failure to adequately justify costs when weighed against the no harm test would therefore be to the risk of shareholders and not customers.¹⁸⁴

...

The Board notes the indication by AUHI¹² that AIT would provide administrative services to Newco to December 31, 2007, renewable yearly thereafter. The Board considers that the administrative services agreement between AIT (or AltaGas Ltd.) and Newco (AUGI) should be extensively reviewed at AUI’s GRA as it applies to allocation of costs to the utility. The Board’s approval of the Application by no means constitutes approval of any underlying costs, changes in service levels, contractual obligations, affiliate or shared service agreements or arrangements, changes in risk profile or capital structure, debt financing costs or provisions, or any other areas that may give rise to potential harm to AUI customers as a direct or indirect result of the Transaction.¹⁸⁵

¹² AUHI minutes August 24, 2005 meeting minutes, page 2

The Board does not agree with AUI’s argument that the no-harm test may not be applied in this proceeding. In the proceeding resulting in Decision 2005-112, both interveners and AUHI supported deferring a detailed examination of the ramifications of the Transaction to the next GRA of AUI.¹⁸⁶ For AUHI to encourage that a detailed assessment of the ramifications of the Transaction be deferred until AUI’s next GRA, and for AUI to now argue that the Board may not apply the “no-harm” test in this proceeding, is disingenuous.

In Decision 2003-098,¹⁸⁷ the Board stated that in previous Board decisions respecting the sale of a business, the Board has determined that to the extent that it could deal with any potential financial impact of a sale in future rate applications, it would do so.¹⁸⁸ In Decision 2005-112, the Board also considered the availability of future regulatory proceedings to address any potential adverse impacts that could arise from the Transaction.

¹⁸³ Decision 2005-112, page 4

¹⁸⁴ Decision 2005-112, page 5

¹⁸⁵ Decision 2005-112, pgs 8-9

¹⁸⁶ Decision 2005-112, page 5

¹⁸⁷ Decision 2003-098 – ATCO Electric Ltd., ATCO Gas North and ATCO Gas South, Both Operating Divisions of ATCO Gas and Pipelines Ltd. Trans of Certain Retail Assets to Direct Energy Marketing Ltd and Proposed Arrangement with Direct Energy Reg Services to Perform Certain Regulated Retail Functions (Application 1299855) (Released: December 4, 2003)

¹⁸⁸ Decision 2003-098, page 18

The Board acknowledges the concerns raised by the customer groups in the proceeding leading to Decision 2005-112, that the actual negative ramifications to customers would not be capable of precise exploration until the next GRA and/or debenture application of AUI. The Board considered in Decision 2005-112 that the ramifications of the Transaction should be addressed in the next GRA and that the customers should be no worse off after the Transaction.¹⁸⁹ The present proceeding is the next GRA of AUI, and the first proceeding in which the Board has had an opportunity to fully assess the financial impacts that have arisen subsequent to the Transaction.

The Board considers that making a determination at this stage on whether any financial harm has arisen from the Transaction is consistent with Decision 2005-112, and the submissions of the parties in that proceeding, and is appropriate and warranted. With respect to assessments of financial harm, the Board must be satisfied that the Transaction has either not harmed customers or, on balance, has left them at least no worse off than before the Transaction in terms of financial impacts. In order to assess financial harm, the Board will consider the evidence and conduct a balancing of both the positive and negative financial impacts of the Transaction. If, having regard to all of the circumstances, the balance favours customers, or leaves them no worse off, no financial harm will be found.

AUI indicated that the significant increases in inter-affiliate costs were the result of AIT's cost allocation model not being updated regularly and rigorously.¹⁹⁰ However when in BR-AUI-27(b) the Board requested substantiation of this claim, AUI produced a table that showed the 2007 forecast amounts and reduced those amounts by inflation to show the alleged shortfalls in those charges in the years 1999-2006. The Board does not find AUI's response or attempt at substantiating its claim to be persuasive, given that it began with the very figures that the Board is being asked to approve in this Decision.¹⁹¹ The Board also notes that KPMG testified that it was not asked to substantiate the subsidy claim.¹⁹²

One of the witnesses on AUI's witness panel, who was representing AIT, also referred to a lack of understanding at the corporate level that inter-affiliate charges could be passed on to the customer.¹⁹³ The Board does not find the position of AUI in this regard to be completely credible, given the weakness of the evidence offered to demonstrate its claim, and given the general capability and sophistication level of AUI and its parent organizations.

In objecting to the proposed cost increases associated with inter-affiliate shared costs contained in the Application, AUMA/UCA considered that the Transaction resulted in harm to customers. Table 56 of the Application indicates that as a result of the Transaction, AUI now receives 91.40% of fiduciary costs based on its proportion of the total assets of the operating businesses owned by AUGI.¹⁹⁴

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

¹⁸⁹ Decision 2005-112, pages 5, 8, 9

¹⁹⁰ Application, page 201

¹⁹¹ Transcript Volume 2, pages 338-343, and pages 235-248

¹⁹² Transcript Volume 2, page 377

¹⁹³ Transcript Volume 2, pages 398-399 and 311

¹⁹⁴ Application, pages 211 and 205

businesses.¹⁹⁵ 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.

In Reply Argument, AUI submitted that customers would arguably be paying \$640,000 more in inter-affiliate shared costs if the Transaction had not occurred. AUI based this amount on the difference between AUI's forecast costs of \$1,858,510 and the pro-forma charge for inter-affiliate services in 2006 calculated by AIT of \$2,497,795¹⁹⁶ (in the revised response to AUMA/UCA 16(a)), yielding a difference of \$639,285.

With regard to the revised response to AUMA/UCA 16(a), the Board notes AUMA/UCA's argument that it provided an apples and oranges comparison, since the response from AIT appeared to be based on a fully allocated model, rather than the previous shared service model, which AUI indicated did not involve a full allocation of costs. The Board observes that while AIT provided a list of services and dollar amounts, the manner in which the information provided was derived was not substantiated by AUI. Additionally, the suggestion of a \$640,000 cost saving was based on the very figures that the Board is being asked to approve in this Decision.

For these reasons, the Board is not persuaded that there has been a \$640,000 cost saving as suggested by AUI in Reply Argument. Other than the suggestion of a \$640,000 cost saving, AUI has not provided any evidence of financial benefits arising from the Transaction. The Board finds that the positive impact of the Transaction of \$640,000 as argued by AUI is not adequately supported by the evidence, and that AUI has not demonstrated sufficient financial benefits to offset the financial impact of the Transaction. The Board finds that the Transaction has left customers worse off in financial terms, and that as a result, without mitigation efforts, customers have suffered financial harm.

Given the Board's finding that financial harm has occurred, the Board finds these costs to be inappropriate and therefore should not be included in just and reasonable rates. The Board considers that it is necessary to mitigate the impact of that harm by reducing inter-affiliate shared costs and the negative impact on customers of the substantial increase in these costs subsequent to the Transaction. AUI indicated in Table 56 of the Application that the total amount associated with the change in allocation from 21.45% to 91.40% is \$632,573. Therefore the Board directs AUI, in the Refiling, to reduce its forecast of inter-affiliate shared costs by \$632,573, subject to the direction below with regard to shareholder-related incentive compensation.

With regard to the incentive compensation component included in shared services charges, the KPMG report raised the following issue:

One possible exception with respect to fairness, as to be determined by the Alberta Energy and Utilities Board (EUB), may be the shareholder-related incentive compensation; these shareholder-related incentive compensation costs are forecast at \$123,000 in 2007.¹⁹⁷

¹⁹⁵ Application, page 210

¹⁹⁶ Exhibit 002-15

¹⁹⁷ Application, Tab 14, page 5 of 85

In Decision 2006-100,¹⁹⁸ the Board issued the following direction with respect to variable pay for the ATCO corporate office and the office of the chairman, which allocate costs to subsidiaries, including regulated subsidiaries:

The Board has reviewed the structure of the Utility Executive VPP program in this Application and is not persuaded that the 50% portion of the Utility Executive VPP related to achievement of increased returns to shareholders will translate into improved utility operational efficiency or other utility benefits. Therefore, the portion of the Utility Executive VPP related to achievement of increased returns is not approved for inclusion in utility revenue requirement. The Board agrees with CG⁵³ that the portion of the Utility Executive VPP related to the achievement of operational metrics should be included in revenue requirements.¹⁹⁹

⁵³ CG Argument, page 33 June 21, 2006

The Board has made similar findings in a number of previous decisions²⁰⁰ and continues to hold these views. The Board disagrees with AUI's argument that AUGI is not unlike any other corporation from which AUI might receive a service. AUGI is the indirect parent of AUI and the Board's typical concerns in regard to shareholder-related incentive compensation would arise. The Board finds that the \$123,000 associated with shareholder-related incentive compensation is inappropriate, should be disallowed from AUI's inter-affiliate costs and should not be included in just and reasonable rates. However, it is not clear to the Board how much of the \$123,000 is included in the \$632,573 amount disallowed by the Board.

Therefore the Board directs AUI in the Refiling to remove all shareholder related incentive compensation amounts from the inter-affiliate shared costs, and to provide a true-up schedule showing the deduction of these amounts. The Board is concerned about the lack of transparency in inter-affiliate shared costs and observes that the \$123,000 figure identified by KPMG was not separately identified in the schedules provided by AUI in the Application.

The Board also notes that AUI indicated that inter-affiliate costs would change in 2008 as noted below:

- 11 A. MR. TUELE: It could. It certainly could.
- 12 The agreement contemplates a term of one year, this
- 13 particular agreement, expiring at the end of 2007. And the
- 14 expectation is that -- and the intention is that both parties
- 15 will review the services, the level of services provided, the
- 16 costs associated with that and then negotiate and execute a
- 17 new agreement. **So certainly, the costs could change -- well,**
- 18 **and will change going into 2008.**²⁰¹

¹⁹⁸ Decision 2006-100 – Decision 2006-100 – ATCO Utilities - 2005-2007 Common Matters Application (Application 1407946) (Released: October 11, 2006)

¹⁹⁹ Decision 2006-100 page 27

²⁰⁰ See, for example, Decision 2003-061 AltaLink Management Ltd. and TransAlta Utilities Corp Transmission Tariffs for May 1, 2002 to April 30, 2004; TransAlta Utilities Corporation Trans Tariffs for January 1, 2002- April 30, 2002, page 52, Decision 2006-004 ATCO Gas 2005-2007 General Rate Application Phase I, pages 62-63, Decision 2006-024, ATCO Electric 2005-2006 General Tariff Application, page 74.

²⁰¹ Transcript Volume 2, page 393

Given the possibility of future applications for inter-affiliate shared costs, the Board notes some of the concerns it had with this filing.

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.²⁰² 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.²⁰³ The Board agrees and considers that any future reports of this nature should clearly differentiate services and ensure there is no duplication.

The Board would have preferred a study that examined and reported more specifically on management time expenditures and costs under the previous allocation methodology compared to the proposed time and costs.

The Board also considers that it would be preferable, in future proceedings where affiliate charges are considered based on expert reports, that there be expert testimony led on behalf of customers, in addition to expert evidence provided by the utility.

The Board questions the appropriateness of several aspects of the ASA, including the following:²⁰⁴

- The fee calculation is in reference to the costs of AUGI, and the method used to calculate and allocate the cost of services is approved by the audit committee of the Board of Directors of AUGI. While this serves to represent the interests of AUGI, and its shareholders, the Board questions the appropriateness of this formulation of a fee calculation, which is to be paid by AUI.
- It is not clear, based on the ASA, what meaningful role AUI has had (if any) in determining and making final decisions on the allocation of the cost AUI is expected to pay under the ASA. Additionally, AUI used AIT's legal counsel to represent it with respect to the ASA.²⁰⁵
- The Board also questions whether AUI's use of the agreement between AIT and AUGI as the basis for the ASA²⁰⁶ was appropriate, and encourages AUI to reconsider its approach to future inter-affiliate agreements, and renewals of such agreements.

The Board is also concerned that the differences between direct and fiduciary cost in the ASA should be defined more clearly in future, and that more complete explanations and definitions between shared services and costs and CEO/CFO certification services and costs would be more helpful.²⁰⁷

²⁰² Exhibit 002-01, Application, Tab 14, pages 4, 9, 12

²⁰³ MGCI Argument, page 14

²⁰⁴ Exhibit 002-01, Tab 15

²⁰⁵ Transcript Volume 2, page 323

²⁰⁶ Transcript Volume 2, pages 319, 320

²⁰⁷ For example, when asked where those differences are documented, AUI was unable to identify any such document: Transcript Volume 2, pages 313-317.

The ASA states that the calculation of total assets, which forms the basis for the allocation of fiduciary services costs to AUI, is based on the second preceding year's audited financial results at the beginning of the term (or renewal term) of the ASA. The term of the ASA began on January 1, 2007. The allocation proportions for 2007 are based on the 2005 audited results. However, for known, new operating companies that do not have audited results, budget figures are used to determine the allocation proportions. The Board directs AUI, in future proceedings, to explain whether its allocation of fiduciary costs is based on audited or budget figures, and if budget figures are proposed to be used, to further provide those figures and address the forecasting risk associated with using only budget figures.

The Board directs AUI in its next GRA, to file an inter-affiliate agreement which complies with the Board approved inter-affiliate Code of Conduct,²⁰⁸ and to provide a full assessment of such compliance at its next GRA.

7.1 Allocation of Fiduciary and Third Party Costs

MGCI noted that fiduciary and third party costs were allocated among the three subsidiary companies of AUGI, namely AUI, Heritage Gas, and Inuvik Gas. MGCI considered that the method of allocation of fiduciary and third party costs proposed in the KPMG review was inappropriate and over-allocated costs to AUI. MGCI proposed that AUI's allocation based on total assets, be replaced with a composite allocator made up of three singular allocators, as follows:

Table 12. MGCI Composite Allocator

Allocator	Allocation to AUI (%)
Total Assets	91.4
Incremental Assets	66.7
Equal Distribution	33.3
Average (Composite Allocator)	63.8

MGCI stated that the proposed methodology would result in 63.8% of fiduciary costs being allocated to AUI, which was more appropriate.

MGCI compared AUI's assets-only allocation method to that of the composite allocator. The MGCI argued that the composite allocator better represents the benefits outlined by AUI for its own allocator. Further, it argued that the composite allocator was more appropriate than the total assets allocator because it considered a wider range of important data pertaining to the three companies and their ongoing relationship with AUGI.

AUI noted MGCI's position that the total asset allocation methodology used to apportion fiduciary costs to AUI was inappropriate as it did not adequately reflect the "assistance and level of attention" that Heritage Gas receives from AUGI.²⁰⁹ AUI argued that there was no evidence on the record with respect to what, if any, assistance or managerial attention AUGI gives Heritage Gas.

²⁰⁸ Exhibit 09-009

²⁰⁹ MGCI Argument, pages 8-10

AUI considered that MGCI introduced the composite allocator as new evidence, in argument. AUI argued that the evidence with respect to the composite allocator cannot be placed on the record, as it was untested by both the Board and AUI.

Views of the Board

A key consideration in determining whether or not the proposed allocation of fiduciary costs is reasonable is whether or not the allocator closely matches how the costs are incurred on behalf of AUI for provision of fiduciary services.

While there may be general duties relating to company financing, such as ongoing access to financial markets, and establishing and maintaining relationships in this area²¹⁰ there are other duties which are very specific and focused in nature such as debt placement. These duties arise from time to time but may not be ongoing in all years. In this regard, it was AUI's evidence that it would not be accessing the debt markets in 2007. Given the varied nature of these costs, and the fact that AUI will not be accessing the debt markets in 2007, the Board considers that allocating these costs on the basis of total assets may not accurately reflect how these costs are incurred on AUI's behalf.

Further, due to the size of AUI in comparison to Heritage Gas and Inuvik Gas, 91.40% of fiduciary costs are allocated to AUI. Given the Board's concern that allocating fiduciary costs based on total assets may not reflect how these costs are incurred, the Board considers that fiduciary costs allocated to AUI may be overstated, and might not result in just and reasonable rates.

In support of its allocation of fiduciary costs, AUI argued that the proposed methodology is supported by regulatory precedent – it submitted that ATCO, the largest investor owned utility in Alberta, employs the same methodology.²¹¹ However, the Board notes that ATCO does not employ the same methodology, but rather, as indicated in Decision 2006-100 uses a composite allocator based on revenues, total assets and capital expenditures.²¹² Given the nature of fiduciary services, the Board considers that the use of a composite allocator would be a more appropriate way to allocate these costs.

While MGCI proposed a composite allocator, the Board agrees with AUI that MGCI should have filed evidence with respect to this alternate proposal so that it could be fully tested. In the absence of such evidence on a composite allocator, the Board considers that it is appropriate that this matter be reviewed further. Therefore the Board directs AUI in its next GRA to propose a composite allocation methodology for fiduciary services that takes into account how these costs are incurred, along with a full explanation of the rationale underlying its proposed methodology. The Board considers that as part of the study, AUI should address the issue of whether management time and attention should be considered in the allocation formula.

For the purposes of this Application, the Board accepts the allocation methodology for fiduciary costs as proposed by AUI.

²¹⁰ Transcript Volume2, page 330, line 11 to page 331, line 12

²¹¹ Exhibits 002-01, page 212 and Tab 14 KPMG Inter-Affiliate Charges – Shared Costs Study Appendix A Section 2.1; 002-010 MGCI-AUI 21; and Transcript Volume 2, pages 269-270 and 299-300

²¹² Decision 2006-100, page 25

8 GAS COST RECOVERY

Gas costs are a pass-through cost, which are recovered in a monthly filing process by way of the gas cost recovery rate (GCRR) through AUI's deferred gas account. AUI provided a gas cost forecast in the Application as an input for determining other components of its filing, primarily gross penalty revenue.²¹³

MGCI noted that AUI included transportation costs in the gas cost detail but in its 2005-2006 Phase II proceeding (application no. 1491262), which resulted in Decision 2007-079, AUI had proposed a third party transportation rate rider (TPTR)²¹⁴ that would eliminate that problem by charging all upstream transportation costs to all distribution customers. MGCI further noted that in that proceeding it had recommended, and continued to advocate, that transportation costs should be moved to revenue requirement and recovered through base rates, thereby eliminating cross subsidization of retail customers by default supply customers, and achieving a fair sharing of forecast risk between AUI and its customers.

AUI opposed MGCI's proposal to transfer transportation costs to base rates for two primary reasons:

- (1) in its 2005-2006 Phase II GRA, AUI proposed the TPTR that was intended to address the cross subsidization issue, and
- (2) AUI has never included transportation cost in its revenue requirement, and considers its approach to be appropriate, since these costs are gas related costs for which AUI should not bear any forecasting risk.

Views of the Board

In Decision 2007-079 the Board approved, effective November 1, 2007, the TPTR for AUI.²¹⁵ As this rate recovers those transportation costs that were previously included the GCRR, the Board considers that further review of the mechanism for recovery by AUI is presently not required.

9 DEPRECIATION AND AMORTIZATION EXPENSE

Depreciation expense for the plant accounts included in intangible plant, transmission plant, distribution plant, and general plant was calculated using the rates and method accepted by the Board in Decision 2005-127. To support its calculations, AUI provided a 2007 Technical Update²¹⁶ to the study prepared for its 2005-2006 GRA. For 2007, AUI forecast depreciation expense of \$9,330,125.

AUMA/UCA confirmed that the depreciation rates used by AUI in the Application corresponded to AUI's second compliance filing in respect of its 2005-2006 GRA (Application No. 1474463).

²¹³ Exhibit 002-01, page 215; Exhibit 002-06-01, pages 70-71

²¹⁴ Refer to Decision 2007-079, October 16, 2007. The TPTR transferred third party transportation service costs from the deferred gas account to a separate deferral account to ensure that both retail and default supply customers pay their share of those costs.

²¹⁵ Decision 2007-079, Section 5.3, page 36

²¹⁶ Exhibit 002-02

Given the true-up results reflected in the 2007 Technical Update, AUI submitted that the methodology and resulting depreciation rates employed by AUI in its 2007 forecast for depreciation expense are reasonable. AUI noted that the actual amounts for 2005 and 2006 for accumulated depreciation continuity varied by only 0.02% and (1.0) %, respectively, from forecast. AUI's 2005 and 2006 actual amounts for depreciation/amortization expense varied by 1.7% and (0.5) %, respectively, from forecast.

Views of the Board

The Board accepts that the rates and methodology which AUI continues to use to determine its depreciation and amortization expense for 2007 are appropriate. The Board notes that the final determination of the forecast depreciation and amortization amounts for 2007 would be subject to any changes to plant and equipment made by AUI in its Refiling.

10 INCOME TAXES

AUI uses the flow-through method to calculate income tax expense. Under this method, AUI would calculate the least amount of income taxes that would be payable on the income forecasted for the test years concerned. Forecast income taxes are determined in accordance with the legislation as it exists at the particular time and revenue recognition and deductions claimed for income tax purposes in a year can differ from the related amounts used for accounting purposes. However, in respect of forecasts for prospective test years, where announcements of changes to income tax rates and tax laws by the government may have the substantive effect of actual enactment, the changes are used in the forecasted income tax calculation.

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 ordinarily treated as deferral amounts there is certain forecast risk for the amounts included in the revenue requirement.

10.1 Directions Relating to Income Tax in Decision 2005-127

With respect to Direction 31 in Decision 2005-127, which directed AUI to provide an opinion from its income tax advisor, AUI stated that it relied on its internal tax specialists. It stated that the costs that it had historically capitalized were generally consistent with what other utilities had capitalized. Additionally, AUI confirmed that its flow-through tax methodology maximizes deductions, with the exception of its customer information system (CIS) related costs, which in turn had been supported by AUI's external auditors' review of AUI's tax filings.²¹⁷ Accordingly, AUI considered that it had complied with the Board's direction.

Views of the Board

The Board notes that AUI has not complied with Direction 31 in Decision 2005-127 to provide a written opinion from its income tax advisor concerning the deductibility of costs it had historically capitalized for income tax purposes. The Board was seeking assurance that AUI was maximizing its deductions as required under the flow-through method. However the Board notes

²¹⁷ Exhibits 002-01 page 219; 002-05 BR-AUI-30; 002-09 CCA-AUI-49; and Transcript Volume 3, pages 504-506 558-559

that AUI testified that it did consult with an internal tax advisor on this matter and was subsequently satisfied that the income tax deductions concerned have been maximized. While this testimony lacks the written opinion the Board was seeking in the Direction, the Board, nevertheless, accepts that AUI's policy in all material respects is to include in its approved revenue requirement the least amount of income taxes that would be determined in accordance with income tax laws that exist or are expected to be enacted during a test period. Therefore, for purposes of this Decision, the Board accepts the response of AUI.

10.2 2006 Federal and Alberta Budget Changes

CCA submitted that in AUI's 2005-2006 Phase 1 GRA, AUI led interveners and the Board to believe it would implement changes arising from the federal and Alberta budgets "if and when they materialized." CCA argued that the changes materialized, but customers had not seen the intended benefits.

CCA noted the occurrence of reductions in the large corporations tax in 2005 (0.22%) and 2006 (1.55%) and the reduction in Alberta corporate income tax rate in 2006 (1.12%). CCA recommended that the Board direct AUI to file detailed calculations in support of the reductions in income taxes for the test years 2005 and 2006 as a result of the enactment of the 2005 and 2006 federal and Alberta budgets. CCA considered that these amounts should serve to reduce the deficit, if any, for the 2007 GRA.

To avoid the problem faced in the 2005-2006 GRA, where AUI did not give effect to the budget changes as these had not been substantially enacted, CCA recommended that AUI be directed to set up a deferral account to capture all changes arising from the 2006 federal and Alberta budgets to the extent these changes impact the income tax as filed in the 2007 Phase 1 GRA.

AUI noted that to the extent the 2005 and the 2006 federal and Alberta budget tax changes were substantially enacted after the 2005-2006 GRA filing, these changes would simply be considered forecasting differences.²¹⁸ AUI disagreed with CCA's view that it did not comply with respect to proposed changes in legislation arising out of the federal and Alberta budgets. AUI submitted that there appeared to be confusion about what AUI indicated it would do during its 2005-2006 GRA and what the Board had approved in Decision 2005-127 with respect to income taxes. AUI submitted that following a review of Decision 2005-127 and AUI's subsequent compliance filings, AUI concluded that it had complied with the Board's directions relating to income taxes in Decision 2005-127.

AUI submitted that there was no need for the use of a deferral account for income taxes. AUI stated that its practice in the past with respect to the 2005 and 2006 years had demonstrated that any impacts affecting income taxes as filed in an application that may arise as a result of federal and Alberta budgets can be dealt with in a compliance filing.

Views of the Board

The Board considers that requiring AUI to recalculate income taxes for a past test year to effect changes in income tax legislation, as suggested by CCA, is tantamount to using a deferral account for income taxes and thereby treating income taxes as a flow-through cost. The Board also considers that a forecast of income tax includes a risk similar to that inherent in respect of

²¹⁸ Transcript Volume 3, page 442, lines 2-13

other components of revenue requirement normally forecast for prospective test years. In Decision 2005-127, the Board rejected the use of a deferral account by AUI for income taxes and continues to be of the view that it is not necessary to direct AUI to recalculate its income taxes for 2005 and 2006.

10.3 Class 12 Capital Cost Allowance

CCA noted that AUI, in computing its income taxes for 2007, did not claim the maximum capital cost allowance (tax depreciation) on certain assets included in class 12 and, as a result, there was approximately \$1.1 million of additional capital cost allowance that it could deduct in 2007. CCA considered that customers seek to have the least amount of income taxes included in their rates since the present value of a dollar today is worth more than a dollar received in the future. CCA recommended that, as AUI uses the flow-through method for computing income taxes in which the principle of maximizing tax deductions applies, AUI be directed to re-file its 2007 GRA claiming the maximum capital cost allowance.

AUI agreed that it had not maximized the tax deduction associated with depreciating the remaining balance of the e-CIS system (included in class 12 for capital cost allowance purposes). AUI, however, also indicated that it would comply with a Board direction to reflect in its 2007 forecast the maximum capital cost allowance allowed on the e-CIS system in 2007.²¹⁹

Views of the Board

Unless otherwise approved by the Board, use of the flow-through method to determine income taxes for regulatory purposes mandates that AUI is to maximize all of the deductions allowed under income tax legislation. Consequently, the Board directs AUI, in its Refiling, to claim the maximum capital cost allowance allowed for class 12 assets in the determination of its income tax expense for 2007.

11 NEED FOR A FULLY INTEGRATED REVENUE REQUIREMENT MODEL

CCA was concerned that AUI was reluctant to provide its integrated revenue requirement spreadsheet model. CCA submitted that without access to AUI's model, interveners could not adequately analyze forecasts and proposals put forth by AUI in a GRA, which in turn would result in inefficiencies and an unnecessary increase in hearing costs. CCA noted that, in its experience, other utilities appear to have no difficulty in filing revenue requirement financial schedules that are fully linked with all formulae intact. Further, CCA observed that it is not common to have the Board and interveners sign a license agreement in order to obtain access to these spreadsheets, as was suggested by AUI.

AUI noted that during the course of the hearing and at the request of CCA, AUI agreed to provide to interveners, for use at its next GRA, its integrated revenue requirement spreadsheet model. AUI proposed that the model would be provided in a form that was either devoid of proprietary information or required interveners to enter into confidential licensing agreement.²²⁰

²¹⁹ Transcript Volume 3, pages 501-502

²²⁰ Transcript Volume 1, pages 203-204

Views of the Board

The Board agrees that an integrated revenue requirement spreadsheet model, and other types of formula based schedules that are in electronic format, are tools that can significantly facilitate the analysis of a utility's application. The Board notes that AUI has agreed to provide to interveners, to the extent possible, a model that is either devoid of proprietary information or requires interveners to enter into confidential licensing agreement. The Board encourages AUI to maximize the amount of linked information available and understands that other proceedings have made use of integrated spreadsheets without issues relating to proprietary data. The Board considers that proprietary or confidential information should not be an obstacle for AUI given past practice in other proceedings.

12 SINGLE TEST YEAR

AUI submitted that, due to a number of material cost drivers,²²¹ it was concerned about its ability to forecast its revenue requirement for test years beyond 2007. AUI argued that because of the significant forecasting risk that exists with respect to these cost drivers, it sought approval of a single 2007 test year, and provided four main reasons which together provided the basis for justifying a single test year:²²²

1. the December 31, 2007 expiry of AUI's collective agreement with its unionized staff, which comprise approximately one half of AUI's overall labour costs,
2. the application of [EUB Directive 012](#), the Tariff Billing Code²²³ (TBC),
3. the significant cost increases forecast for 2007 relating to various areas of AUI's operations, most notably inter-affiliate charges (shared costs and expenses relating to CEO/CFO certification), and
4. the uncertainty of AUI's cost of debt, given its leave to appeal application of Decision 2006-049.

AUMA/UCA addressed each of the four reasons proffered by AUI in some detail and concluded that none of these reasons, either individually or collectively, justified the use of a single test year. AUMA/UCA considered that a shorter test period was intended merely to reduce risks compared to a longer test period and that customers should not be required to reduce AUI's risk and, at the same time, bear the additional regulatory costs.

CCA agreed with AUMA/UCA that the reasons provided by AUI were not sufficient to warrant filing a single year GRA.

AUI submitted that the cost of the Application was small, approximately \$190,000, which was approximately 0.5% of AUI's applied for revenue requirement and would be in part offset by it foregoing an associated Phase II application.²²⁴ AUI also submitted that the cost amount was small relative to the potential savings for ratepayers due to overpayments arising from forecasting risk. AUI noted that it had not previously sought approval for a single test year in over twenty five years.

²²¹ Exhibits 002-01 page 3; and 002-17

²²² Exhibits 002-01 page 3; and 002-17

²²³ Board *Directive 012 Alberta Tariff Billing Code (Version 1.3)*

²²⁴ Exhibit 002-08 AUMA/UCA 2(e) – (f); and Transcript Volume 1, pages 47-48

Views of the Board

The Board does not generally favour a single test year for purposes of determining a Phase I GRA. Any cost savings that may result from AUI not filing an associated Phase II GRA is a separate issue. In respect of subsequent applications for a GRA, AUI stated that it intends to file a 2008 - 2009 Phase I GRA in 2008, with an associated Phase II GRA filed shortly thereafter.

The Board agrees that, in general, a single-year forecast may be more accurate than a multi-year forecast and in general, tends to mitigate risk and uncertainty. However, the Board does not necessarily agree that the use of single test year will translate into increased forecasting accuracy for a subsequent GRA that includes more than one test year. Traditional ratemaking is done prospectively and thus is inherently subject to uncertainty and risk. The accuracy of the forecasts used to determine the revenue requirement depends on pertinent and reliable information and other tools available for the purpose at any particular time.

The Board notes the views of the interveners that the reasons given by AUI for choosing a one-year test period are not compelling. However, the Board is aware of other regulated utilities that have used single test years on occasion, overall, the Board is not convinced in this case that it should disallow a portion of AUI's forecast costs for the 2007 Phase I GRA, as submitted by AUMA/UCA. The Board notes that all hearing costs are subject to Directive 31B, and expects AUI to demonstrate to the Board's satisfaction that any costs have been prudently incurred.

13 EMPLOYEE BENEFITS CAPITALIZED

In comparing actual results to forecast for 2006, AUMA/UCA noted that AUI charged \$506,300 more to capital than forecast and \$300,600 less to salaries than forecast. AUMA/UCA believed the differences to be the result of increasing the percentage charged to capital from the 20% forecast to 25% on an actual basis. AUMA/UCA was concerned that as a result of this change customers would end up being charged twice for the reduction in salary expense and submitted that the opening balance of plant-in-service for 2007 should be reduced by \$300,000.

AUI disagreed with AUMA/UCA that the opening balance of plant-in-service be reduced by \$300,000. AUI submitted that a significant increase in actual new service attachments over forecast in 2006 resulted in a large number of new unanticipated FTEs in 2006 and the incurrence of large variances between allowed and actual operating and capital costs. AUI argued that an adjustment of the opening balance of plant-in-service would, in effect, be retroactive rate making.

Views of the Board

The Board accepts AUI's explanation in respect of the variances between actual and forecast amounts of employee benefits capitalized in 2006. Consequently, the Board will not require AUI to adjust its 2007 opening balance of plant-in-service in the manner recommended by AUMA/UCA.

14 TARIFF BILLING CODE

On December 19, 2006, AUI filed an application (no. 1493238) with the Board requesting a permanent exemption from the TBC. On June 19, 2007, AUI requested an extension to the temporary exemption from compliance with the requirements of the TBC. The initial temporary exemption was granted on June 30, 2006 and was set to expire on June 30, 2007. In a letter dated June 29, 2007, the Board extended AUI's temporary exemption from the TBC to March 31, 2008.

MGCI submitted that customers would not support an order or direction forcing AUI into full compliance with the TBC. Retailers have demonstrated very little interest in AUI's customers or service area as evidenced by the low level of retail supply within the AUI system (approximately 1.25%).²²⁵ AUI's evidence was that retailers simply did not see AUI's service territory or customers as "low-hanging fruit" and appeared to be more interested in the Edmonton and Calgary market where retail penetration was still "probably only in the 20–some percent" range.²²⁶

MGCI recognized that AUI's exemption from the TBC has been extended to March 31, 2008.²²⁷ MGCI also noted AUI's evidence that it anticipated no work on compliance until 2008.²²⁸ Nonetheless, the MGCI advised the Board that it was not in favor of forcing AUI to full compliance with the tariff billing code given the nebulous benefits and significant costs.

Views of the Board

The Board is of the view that a determination regarding AUI's request for a permanent exemption to the TBC is beyond the scope of this proceeding. Parties will have an opportunity to express their support or opposition on this matter in a future proceeding.

15 REFILING

The Board directs AUI to revise its 2007 GRA Phase I to reflect the Board's findings, conclusions and directions in this Decision and to refile the amended GRA by January 18, 2008. The Board expects AUI in its Refiling to provide a summary of all adjustments made, including details of any associated impact on NWC, taxes, depreciation, or any other related areas.

Intervenors wishing to comment on AUI's Refiling should file a submission with the Board by February 1, 2008.

²²⁵ Transcript Volume 1, page 192, line 15-23

²²⁶ Transcript Volume 1, page 192, line 24 to page 193, line 14

²²⁷ Transcript Volume 1, page 55, lines 1-13

²²⁸ Transcript Volume 1, page 40, line 19 to page 41, line 4

16 ORDER

For and subject to the reasons set out in this Decision, IT IS HEREBY ORDERED THAT:

- (1) AltaGas Utilities Inc. shall comply with all Board directions in this Decision.
- (2) AltaGas Utilities Inc. shall refile its 2007 GRA Phase I (the Compliance Filing) as required by this Decision, incorporating the findings, conclusions and directions in this Decision.

Dated in Calgary, Alberta on December 11, 2007.

ALBERTA ENERGY AND UTILITIES BOARD

(original signed by)

C. Dahl Rees, LL.B.
Member

(original signed by)

M. W. Edwards
Acting Member

APPENDIX 1 – HEARING PARTICIPANTS

Name of Organization (Abbreviation) Counsel or Representative (APPLICANTS)	Witnesses
AltaGas Utilities Inc. (AUI or AltaGas) C.K. Yates D. Langen	E.A. Tuele, President, AUI B. Emmerzael, Vice President Operating Services, AUI A. Mantei, Vice President Controller, AUI R. Koizumi, Manager, Regulatory Affairs, AUI D. Stein, Vice President Finance, AltaGas Income Trust R. Hillman, Senior Manager Advisory Services, KPMG LLP
Alberta Urban Municipalities Association and Office of the Consumers Advocate (AUMA/UCA) J.A. Bryan, Q.C.	
Consumers Coalition of Alberta J.A. Wacowich	
Municipal and Gas Co-op Intervenors (MGCI) T.D. Marriott	
Aboriginal Communities (ABCOM) J. Graves	
<p>Alberta Energy and Utilities Board</p> <p>Board Panel R. G. Lock, P.Eng., Presiding Member C. Dahl Rees, LLB, Member M. W. Edwards, Acting Member</p> <p>Board Staff S. Wakil (Board Counsel) C. Burt M. McJannet D. R. Weir, CA B. Clarke A. Rabiou</p>	

APPENDIX 2 – SUMMARY OF BOARD 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. No parties objected to AUI's 2007 forecast CIAC and depreciation expense for 2007. Upon review, the Board considers AUI's forecast CIAC and its depreciation methodology and resulting expense is appropriate. Therefore the Board approves AUI's forecast depreciation expense and CIAC as filed. Given the various revisions and updates to the Application, the Board directs AUI in the Refiling, to provide updated schedules that reflect all revisions and Board findings..... 4
2. The Board is of the view that establishing a transparent capitalization policy falls within the Board's purview under the GUA with regard to setting just and reasonable rates. Clear capitalization policies mitigate the potential for double-counting of costs that are capitalized or expensed. Further, it ensures that appropriate rules are in place to guide the utility in determining whether or not particular costs may be capitalized and thereby form a portion of the rate base. Any capitalization policy is subject to some level of discretion, but should be founded on established principles and parameters..... 7
3. The Board agrees with CCA that a more detailed review of AUI's capitalization guideline or policy is appropriate. Therefore the Board directs AUI in its next GRA to file a detailed capitalization policy that addresses the issues raised by CCA, and to provide a full explanation of the rationale underlying its proposed policy. The capitalization policy filed should reflect that capitalized expenses would provide benefit over a period of more than one year. To the extent that the principles underlying the CICA Handbook are applicable, the Board encourages AUI to comply with the CICA Handbook. 7
4. The Board considers AUI's updated AFUDC rate of 6.86% for 2007 appropriately reflects the weighted average cost of capital for CWIP, excluding any reduction resulting from CIAC which is related to financing rate base. However, the Board agrees with CCA that further investigation into whether or not AUI should apply AFUDC on net CWIP is warranted. Therefore the Board directs AUI in its next GRA to review the treatment of AFUDC on CWIP, and provide an explanation of any areas in which the proposed treatment is not consistent with other Alberta utilities regulated by the Board. In any event, AUI should provide a detailed discussion of its findings, including a full explanation of the rationale underlying any proposed changes..... 8
5. Although the Board agrees with AUI that any reduction of the purchasing burden from general plant will simply shift the amount from general plant to other plant, the Board considers that further explanation and support of the appropriateness of the 10% purchasing burden is warranted. Therefore the Board directs AUI in its next GRA to file an assessment of its purchasing burden. If any changes are proposed to this practice, the Board directs AUI to provide a full explanation of the underlying rationale supporting the change. 9
6. No party objected to AUI's new business forecast, beyond AUMA/UCA noting the costs of rural mains should be reduced by \$71,800 in accordance with Exhibit 09-010. Having reviewed Exhibit 09-010, the Board agrees with both AUI and the AUMA/UCA that rural

- mains should be reduced by \$71,800. Therefore, the Board directs AUI, in its Refiling, to reduce its 2007 forecast of rural mains by \$71,800. 11
7. Although AUI did not provide detailed justification of the changes in unit costs for trenching and labor, the Board is prepared to accept the revised forecasts as reflecting the most up-to-date information available. However, in future applications, AUI should provide a full explanation of any significant changes in underlying cost inputs in capital expenditures to allow for adequate testing by the Board and interveners. Therefore the Board directs AUI in future applications to provide a full explanation of any significant changes in underlying cost inputs in capital expenditures, as compared to the original application. 11
 8. Based on the number of updates and revisions to system betterment capital expenditures and other costs items within AUI’s revenue requirement, the Board directs AUI in the Refiling to update all capital expenditure schedules to reflect the findings within this Decision and the updated evidence on the record in this proceeding 14
 9. In future proceedings, the Board considers that it would be more efficient and lead to greater transparency if updates were more clearly indicated. To this end, the Board directs AUI, in future proceedings when updates are made, to produce both a full narrative explanation of the reasons for the changes, along with a table indicating the changes made to the original application, including the original amount, the updated amount, and the magnitude of each change. 14
 10. The Board has reviewed AUI’s forecast general plant capital expenditures and determined that the forecast appears to be reasonable. Based on the number of updates and revisions to capital expenditures and other cost items within AUI’s revenue requirement, the Board directs AUI in the Refiling to update all schedules to reflect all findings within this Decision and the updated evidence on the record in this proceeding. 14
 11. While AUI referred to its revenue lag study that involved 32,000 of its customers, it did not file this study in order to allow it to be reviewed and tested in this proceeding. AUI considers revenue lag to be a subjective utility specific attribute, and stated that its previously approved revenue lag was erroneous. Referencing the study, but not filing it as evidence in this proceeding, does not persuasively demonstrate to the Board that the updated analysis has corrected a previous error, particularly if any measure of subjectivity is involved..... 17
 12. The Board agrees that customers would tend to pay bills close to the stated due date but is not convinced that AUI has adequately substantiated the cause for the bill delivery to customers to increase from 16.5 days to 20.8 days. The Board therefore denies AUI’s request for the proposed increases in its revenue lag to 41.6 days. The Board directs AUI in its Refiling, to use the previously approved revenue lag of 37.3 days for purposes of determining NWC for the 2007 test year. 17
 13. With regard to the arguments made by the parties regarding ATCO Gas’s revenue lag, in making its determination, the Board did not consider that the circumstances involving ATCO Gas were readily comparable with those of AUI and therefore gave no weight to ATCO Gas’ revenue lag. 17
 14. For purposes of forecasting, the Board finds the due date of the municipal taxes to be the appropriate lag time to be reflected in the revenue requirement. The Board will therefore accept the CCA’s recommendation to reduce the net lag period for municipal taxes by three days. The Board notes that AUI was not opposed to this reduction. Therefore the Board directs AUI, in its Refiling, to use a net lag period of 41.6 days to determine NWC associated with municipal taxes. 18

15. The Board notes that the EUB Special Deposits were previously approved as a component of NWC in Decision 2005-127 and agrees with AUI that their inclusion in NWC remains appropriate. However, the Board considers that fairness dictates any interest earned on those deposits should also be taken into consideration by AUI. Therefore, the Board directs AUI, in its Refiling, to include its estimate of the interest to be earned on the EUB Special Deposits as a revenue offset..... 19
16. The Board notes that AUI updated the forecast costs for its 2007 Phase I GRA to approximately \$362,000, for inclusion in its deferred regulatory account. The Board also notes that these costs are significantly in excess of the amounts, incurred for its 2005-2006 Phase I GRA. While the Board is not convinced that it should disallow AUI's forecast costs for the 2007 Phase I GRA in the amounts as submitted by AUMA/UCA, the Board considers that the amount to be included in the deferred regulatory account should be reduced. For purposes of the Application, the Board considers that AUI's original forecast costs of \$239,500 would be an appropriate amount to include in the deferred regulatory account. Therefore the Board directs AUI in the Refiling to use the amount of \$239,500 for the 2007 Phase I GRA costs in its deferred regulatory account and to reflect that amount and the related amortization in its Refiling. The Board notes that all actual hearing costs, which may be in excess of the forecast amounts, are subject to Directive 31B, and expects AUI to demonstrate to the Board's satisfaction in the cost claim process that its costs have been prudently incurred..... 22
17. The Board also finds that AUI has not demonstrated that the costs respecting the R&V Application are reasonable for recovery during the 2007 test period. Accordingly, the Board disallows these costs. The Board directs AUI, in its Refiling application, to remove from AUI's deferred regulatory account the amount of \$75,800 incurred or forecast in respect of its R&V Application and to adjust its revenue requirement to reflect the reduced amortization of deferred regulatory costs resulting from the disallowed costs. 22
18. Further the Board directs AUI in its Refiling to provide a reconciliation of its deferred regulatory account setting out the details of amounts forecast, amounts actually incurred, with reference to any related cost claims approved by the Board, and amounts disallowed between the previously approved forecast balance at December 31, 2006 and the revised balance at December 31, 2007..... 23
19. The Board observes that AUI indicated that it expects its CEO/CFO certification costs to be reduced dramatically, to an estimated level in the range of \$25,000 to a \$50,000 maximum, starting in 2008. The Board approves AUI's reconciliation of its 2005 and 2006 CEO/CFO certification costs for 2005 and 2006 and approves AUI's forecast for those costs in 2007.. 26
20. The Board notes that AUI was not opposed to amortizing the balance of \$844,200 at December 31, 2006 and the additional forecast amounts of \$620,600 for 2007 through 2009, as recommended by AUMA/UCA. The Board considers that the longer amortization period is reasonable under the circumstances given the amount of costs incurred by AUI. Therefore, the Board directs AUI, in its Refiling, to provide for the amortization of those costs in its CEO/CFO certification cost deferral account uniformly over the period 2007 through 2009 and to file a reconciliation of the forecast 2007 costs with the amounts actually incurred. 26
21. Therefore the Board directs AUI in the Refiling to use the five-year trend analysis in projecting annual usage forecasts for Residential, Commercial, Rural and Large General Service customers. 28

22. The Board directs AUI in future GRAs, when using surveys such as the Mercer Report, to provide additional information that allows for valid industry comparisons between AUI and other representative utilities. The information should include, but not be limited to, a description of both the market and the industry in which the comparative utilities participate, the size of the comparative utility and the number of employees..... 30
23. Given the above, the Board finds AUMA/UCA's recommendation to update the slippage vacancy rate to 2.0 FTEs, to be excessive. However, based on the lack of clarity as to the two positions being deferred, the Board considers that it would be appropriate to increase the slippage rate by 1.5 FTEs. Therefore, the Board directs AUI in its refiling to reduce salary expense by \$84,375 and capitalized salary costs by \$28,125 to reflect an increase in the slippage vacancy rate by 1.5 FTEs, bringing the approved vacancy rate to 4.5 FTEs. 31
24. The Board considers that an appropriate vacancy rate would fall somewhere between the 2.3 FTE and 5.0 FTE frictional vacancy rates proposed by AUI and AUMA/UCA respectively. Given the 2006 FTE frictional vacancy rate of 3.9, the Board considers this to be a more realistic indicator for 2007, given the continued nature of Alberta's employment economy. Therefore the Board directs AUI in its Refiling to reduce total salary expense to reflect a frictional vacancy rate of 3.9 FTEs..... 32
25. Therefore the Board directs AUI in its refiling 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)..... 35
26. In addition, the Board directs AUI in the Refiling to provide an updated table similar to table in AUMA/UCA-AUI-10(b) that illustrates the changes to STIP..... 35
27. 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. 35
28. 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. 35
29. Therefore, the Board directs AUI in its Refiling to reduce its maintenance contract expense forecast by \$26,600..... 37

30. Accordingly, the Board directs AUI in the Refiling to include its 2005 and 2006 GUA audit costs associated as part of AUI's deferred regulatory costs. The Board further directs AUI in its Refiling to provide a reconciliation of its 2005 and 2006 GUA audit costs setting out the details of amounts forecast and amounts actually incurred and to reflect the increased amortization of deferred regulatory costs resulting from the inclusion of these GUA audit costs. Additionally, the Board directs AUI, in its Refiling and in future GRAs, to identify and reconcile all costs associated with annual GUA audits. 38
31. Therefore the Board directs AUI in its Refiling to reduce its leak survey forecast by \$55,100, reduce its lowering of high pressure lines forecast by \$45,000, reduce its pipeline maintenance forecast by \$96,550, and to reduce its general operating forecast by \$29,100; for a total reduction of \$225,750 to AUI's 2007 material, contractor and other O&M expense forecast. 40
32. Although the community expense item is small, the Board does not consider it appropriate for these costs to be borne by ratepayers. The Board continues to hold the view that sponsorship of community events should not be included in revenue requirement. Therefore the Board directs AUI in its compliance filing to reflect a reduction of \$20,000..... 41
33. Given the Board's finding that financial harm has occurred, the Board finds these costs to be inappropriate and therefore should not be included in just and reasonable rates. The Board considers that it is necessary to mitigate the impact of that harm by reducing inter-affiliate shared costs and the negative impact on customers of the substantial increase in these costs subsequent to the Transaction. AUI indicated in Table 56 of the Application that the total amount associated with the change in allocation from 21.45% to 91.40% is \$632,573. Therefore the Board directs AUI, in the Refiling, to reduce its forecast of inter-affiliate shared costs by \$632,573, subject to the direction below with regard to shareholder-related incentive compensation..... 51
34. Therefore the Board directs AUI in the Refiling to remove all shareholder related incentive compensation amounts from the inter-affiliate shared costs, and to provide a true-up schedule showing the deduction of these amounts. The Board is concerned about the lack of transparency in inter-affiliate shared costs and observes that the \$123,000 figure identified by KPMG was not separately identified in the schedules provided by AUI in the Application. 52
35. The ASA states that the calculation of total assets, which forms the basis for the allocation of fiduciary services costs to AUI, is based on the second preceding year's audited financial results at the beginning of the term (or renewal term) of the ASA. The term of the ASA began on January 1, 2007. The allocation proportions for 2007 are based on the 2005 audited results. However, for known, new operating companies that do not have audited results, budget figures are used to determine the allocation proportions. The Board directs AUI, in future proceedings, to explain whether its allocation of fiduciary costs is based on audited or budget figures, and if budget figures are proposed to be used, to further provide those figures and address the forecasting risk associated with using only budget figures..... 54
36. The Board directs AUI in its next GRA, to file an inter-affiliate agreement which complies with the Board approved inter-affiliate Code of Conduct, and to provide a full assessment of such compliance at its next GRA..... 54
37. While MGCI proposed a composite allocator, the Board agrees with AUI that MGCI should have filed evidence with respect to this alternate proposal so that it could be fully tested. In the absence of such evidence on a composite allocator, the Board considers that it is appropriate that this matter be reviewed further. Therefore the Board directs AUI in its next

- GRA to propose a composite allocation methodology for fiduciary services that takes into account how these costs are incurred, along with a full explanation of the rationale underlying its proposed methodology. The Board considers that as part of the study, AUI should address the issue of whether management time and attention should be considered in the allocation formula. 55
38. Unless otherwise approved by the Board, use of the flow-through method to determine income taxes for regulatory purposes mandates that AUI is to maximize all of the deductions allowed under income tax legislation. Consequently, the Board directs AUI, in its Refiling, to claim the maximum capital cost allowance allowed for class 12 assets in the determination of its income tax expense for 2007..... 59
39. The Board notes the views of the interveners that the reasons given by AUI for choosing a one-year test period are not compelling. However, the Board is aware of other regulated utilities that have used single test years on occasion, overall, the Board is not convinced in this case that it should disallow a portion of AUI's forecast costs for the 2007 Phase I GRA, as submitted by AUMA/UCA. The Board notes that all hearing costs are subject to Directive 31B, and expects AUI to demonstrate to the Board's satisfaction that any costs have been prudently incurred..... 61
40. The Board directs 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. The Board expects AUI in its Refiling to provide a summary of all adjustments made, including details of any associated impact on NWC, taxes, depreciation, or any other related areas. 62

APPENDIX 3 – SUMMARY OF KEY FINDINGS OR BOARD FINDINGS AND CONCLUSIONS

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

1. No parties objected to the opening balances of any line items (including gross plant in service, accumulated depreciation, working capital, contributions in aid of construction (CIAC), mid-year plant in service, and mid-year rate base net of CIAC) included in AUI's Rate Base Schedule 2.3. Upon review of the record for this proceeding, the Board is satisfied with AUI's explanations of any variances between the allowed forecast for the 2005 and 2006 test years and actual results. Therefore the Board approves AUI's opening rate base balances utilized in AUI's 2007 rate base forecast..... 4
2. The Board considers that AUI has provided satisfactory evidence regarding its capital overheads. Accordingly, the Board approves AUI's capital overheads and project overhead items, subject to any findings in this Decision and revisions included in AUI's compliance filing..... 5
3. The Board considers that AUI's 35% capitalization rate for administration expenses and its revision to link the capitalization of benefits with salary are reasonable. No party took exception with this issue. Therefore the Board approves AUI's capitalization rate for administration expenses and the total amount capitalized, subject to any changes resulting from the Board findings in this decision..... 5
4. The Board approves AUI's 2007 new business capital expenditures forecast, subject to AUI applying the aforementioned reduction of \$71,800 associated with rural mains. 11
5. The Board approves AUI's forecast of \$954,900 for the Leduc south PMS project as updated in Exhibit 09-018. 12
6. After an extensive review of various transcript references, exhibits, AUI's original and revised application, the Board is satisfied that AUI has adequately explained its revisions to forecast looping expenditures. Further, the Board considers that these looping expenditures fall below the threshold required for filing business cases. Therefore the Board approves AUI's forecast looping expenditures. 13
7. Because of concerns of estimating the annual EUB assessment, the Board had previously agreed that AUI should recover the assessed costs through the deferred regulatory account. Therefore, the Board approves the treatment of the EUB assessment in the manner and amount as filed by AUI..... 24
8. The Board agrees that the UCA assessment costs are similar to the EUB assessment costs and also considers that the annual assessment amounts may be subject to the uncertainty involved in forecasting. The Board therefore accepts that the UCA assessment costs should be included in AUI's deferred regulatory account and approves the amount as filed..... 24
9. The Board does not agree with AUI's use of a three year data set to determine the 2007 usage forecasts for residential and commercial customers. The Board considers that the three year data set does not appropriately capture the long term trends that are occurring for these customers. Further, using a three year data set does not allow sufficient time for variations in

- weather or other anomalies to be averaged out. On this basis the Board rejects AUI's 2007 usage forecasts for residential and rural customers. 28
10. The Board finds that AUI's proposed 5.5% applied-for salary increase for its non-bargaining unit employees is reasonable and acceptable for the 2007 test-year. Accordingly, the Board finds AUI's adjustment to reflect the lag between Alberta CPI and AUI compounded salaries since January 2002 to be reasonable and necessary. Therefore, the Board approves AUI's 5.5% applied-for salary increase for its non-bargaining unit employees for 2007..... 30
11. Taking into consideration the continuing low unemployment rate in Alberta and the difficulties that AUI is experiencing with respect to filling forecast new positions, the Board considers that AUMA/UCA's proposed frictional vacancy rate of 5.0 FTE does not reflect the recent downward trend of 2004, 2005 and 2006. Further, the 5.0 frictional vacancy rate was significantly greater than the 3.9 frictional vacancy rate experienced in 2006, leading the Board to conclude that AUMA/UCA's proposed vacancy rate may be too high. In contrast, the Board notes the tight Alberta labour market which leads the Board to conclude that AUI's proposed 2.3 frictional vacancy rate is too low. 32
12. 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..... 35
13. Further, given the current economic conditions in Alberta and AUI's increased manpower complement and number of vehicles, the Board finds it reasonable to expect that vehicle allowance and mileage would be comparable to, if not higher than, 2006 levels. 36
14. Based on these findings the Board concludes that AUI's forecast vehicle expenses are reasonable for the 2007 test period. Therefore the Board approves AUI's forecast vehicle expenditures of \$1,056,500 for 2007. 36
15. For the purposes of this Application, the Board accepts the allocation methodology for fiduciary costs as proposed by AUI. 55
16. In Decision 2007-079 the Board approved, effective November 1, 2007, the TPTR for AUI. As this rate recovers those transportation costs that were previously included the GCRR, the Board considers that further review of the mechanism for recovery by AUI is presently not required. 56
17. The Board accepts that the rates and methodology which AUI continues to use to determine its depreciation and amortization expense for 2007 are appropriate. The Board notes that the final determination of the forecast depreciation and amortization amounts for 2007 would be subject to any changes to plant and equipment made by AUI in its Refiling. 57
18. The Board notes that AUI has not complied with Direction 31 in Decision 2005-127 to provide a written opinion from its income tax advisor concerning the deductibility of costs it had historically capitalized for income tax purposes. The Board was seeking assurance that AUI was maximizing its deductions as required under the flow-through method. However the Board notes that AUI testified that it did consult with an internal tax advisor on this matter and was subsequently satisfied that the income tax deductions concerned have been maximized. While this testimony lacks the written opinion the Board was seeking in the

Direction, the Board, nevertheless, accepts that AUI's policy in all material respects is to include in its approved revenue requirement the least amount of income taxes that would be determined in accordance with income tax laws that exist or are expected to be enacted during a test period. Therefore, for purposes of this Decision, the Board accepts the response of AUI. 57

19. The Board considers that requiring AUI to recalculate income taxes for a past test year to effect changes in income tax legislation, as suggested by CCA, is tantamount to using a deferral account for income taxes and thereby treating income taxes as a flow-through cost. The Board also considers that a forecast of income tax includes a risk similar to that inherent in respect of other components of revenue requirement normally forecast for prospective test years. In Decision 2005-127, the Board rejected the use of a deferral account by AUI for income taxes and continues to be of the view that it is not necessary to direct AUI to recalculate its income taxes for 2005 and 2006. 58
20. The Board agrees that an integrated revenue requirement spreadsheet model, and other types of formula based schedules that are in electronic format, are tools that can significantly facilitate the analysis of a utility's application. The Board notes that AUI has agreed to provide to interveners, to the extent possible, a model that is either devoid of proprietary information or requires interveners to enter into confidential licensing agreement. The Board encourages AUI to maximize the amount of linked information available and understands that other proceedings have made use of integrated spreadsheets without issues relating to proprietary data. The Board considers that proprietary or confidential information should not be an obstacle for AUI given past practice in other proceedings. 60
21. The Board accepts AUI's explanation in respect of the variances between actual and forecast amounts of employee benefits capitalized in 2006. Consequently, the Board will not require AUI to adjust its 2007 opening balance of plant-in-service in the manner recommended by AUMA/UCA. 61
22. The Board is of the view that a determination regarding AUI's request for a permanent exemption to the TBC is beyond the scope of this proceeding. Parties will have an opportunity to express their support or opposition on this matter in a future proceeding. 62