



AltaGas Utilities Inc.

2005/2006 General Rate Application
Phase I

November 29, 2005

ALBERTA ENERGY AND UTILITIES BOARD

Decision 2005-127: AltaGas Utilities Inc.
2005/2006 General Rate Application – Phase I
Application No. 1378000

November 29, 2005

Published by

Alberta Energy and Utilities Board
640 – 5 Avenue SW
Calgary, Alberta
T2P 3G4

Telephone: (403) 297-8311
Fax: (403) 297-7040

Web site: www.eub.gov.ab.ca

Contents

1	INTRODUCTION.....	1
2	BACKGROUND	2
3	ISSUES.....	2
4	RATE BASE	2
4.1	Plant and Accumulated Depreciation.....	3
4.1.1	New Business.....	3
4.1.2	Expansion.....	3
4.1.3	System Betterment.....	6
4.1.3.1	Meter Replacements.....	6
4.1.3.2	Regulator Replacements	6
4.1.3.3	Superior System Replacements.....	6
4.1.3.4	Crossing Replacements.....	7
4.1.3.5	Upgrading Projects	8
4.1.3.6	Relocation Projects	8
4.1.3.7	Capitalization of Overheads.....	9
4.1.3.8	Transmission Plant – Pipelines	10
4.1.3.9	General Plant - Tools and Work Equipment.....	10
4.1.3.10	General Plant - Structures and Improvements	11
4.2	Necessary Working Capital (NWC).....	13
4.2.1	Operations and Maintenance (O&M) Inventory.....	13
4.2.2	Hearing Costs.....	14
4.3	Contributions in Aid of Construction.....	14
5	SALES REVENUE AND OTHER INCOME	14
5.1	Penalty Revenues	15
6	COST OF GAS.....	16
6.1	Transportation Costs	16
6.2	Non-commodity Costs	18
7	EXPENSES.....	19
7.1	Leases and Crossing Rentals.....	19
7.2	Maintenance Contracts.....	20
7.3	Bad Debts	21
7.4	Insurance	22
7.5	Audit Fees/Professional Fees	22
7.6	Regulatory Fees.....	24
7.7	Inflation Forecast	25
7.8	Capitalization of Administrative and General (A&G) Expenses.....	25
7.9	Credits to Expenses re Services provided to Affiliates/Affiliate Transactions.....	26
7.10	Compliance with Code of Conduct.....	26
7.11	Short Term Incentive Plan (STIP).....	27
7.12	Charitable Donations and Sponsorships.....	28
7.13	Material, Contractor and Other	29

8	DEPRECIATION EXPENSE AND AMORTIZATION EXPENSE	30
8.1	Account 473 – Services - Net Salvage.....	30
8.2	Account 478 – Meters - Net Salvage	30
8.3	Accounts 483.1 and 486 – Furniture and Equipment and Tools and Work Equipment - Amortization Period.....	31
8.4	5 Year Minimum Amortization Period	31
8.5	Use of 2005 and 2006 Plant Balances to Determine Depreciation Rates	31
8.6	Annual Updates of Depreciation Rates	32
8.7	Simplification of Depreciation Rate Determination	32
9	INCOME TAXES AND LARGE CORPORATIONS TAX	33
9.1	Non-deductible meals	33
9.2	LCT	33
9.3	Engineering and Supervision (E&S) Costs	34
9.4	March 2005 Federal Budget Changes	34
10	COST OF CAPITAL	35
10.1	Return on Common Equity	35
10.2	Cost of Debt	35
11	OTHER	37
11.1	Customer Deposits	37
11.2	Unearned Revenue	37
11.3	AUI Corporate Reorganization	38
11.4	Sufficiency of the Record/Minimum Filing Requirements.....	38
11.5	Compliance Filing.....	39
12	ORDER	40
	APPENDIX 1 – HEARING PARTICIPANTS.....	41
	APPENDIX 2 – SUMMARY OF BOARD DIRECTIONS	42

ALBERTA ENERGY AND UTILITIES BOARD

Calgary Alberta

**ALTAGAS UTILITIES INC.
2005/2006 GENERAL RATE APPLICATION – PHASE I**

**Decision 2005-127
Application No. 1378000**

1 INTRODUCTION

On December 23, 2004, AltaGas Utilities Inc. (AltaGas, AUI, or the Company) filed, under the provisions of the *Gas Utilities Act, Chapter G-5, RSA 2000*, the Phase I portion of its General Rate Application (GRA) (the Application) for the test years 2005 and 2006. AltaGas requested that the Alberta Energy and Utilities Board (EUB or Board):

1. determine a rate base for the Company that is used or required to be used in the Company's service to the public, and fix a corresponding fair return;
2. fix and approve just and reasonable rates, tolls or charges to be imposed and followed by the Company for the delivery of natural gas and related services;
3. give effect to any losses incurred by the Company that may be due to an undue delay in the hearing and determination of the Application; and
4. provide any further determination or direction the Board may consider appropriate.

AltaGas forecasted revenue requirement for the 2005 and 2006 tests years to be \$134,919,992 and \$132,696,344. Under the currently approved sales and transportation rates, the company projected revenue deficiencies of \$4,861,843 and \$5,925,689 for 2005 and 2006, respectively. AltaGas indicated that the main factors that had changed from the amounts allowed by the Board in 2004 were as follows:

	2005	2006
Increased (Decreased) Operating Expense	\$ 2,194,900.00	\$ 3,005,500.00
Increased Depreciation Expense	\$ 1,402,000.00	\$ 1,459,500.00
Increased (Decreased) Return	\$ 170,600.00	\$ 423,700.00
Income and other Taxes	\$ 425,000.00	\$ 568,800.00
	\$ 4,192,500.00	\$ 5,457,500.00
<i>Less</i>		
2004 Deficiency	\$ (629,300.00)	\$ (629,300.00)
Increased Gross Margin and Other Revenues	\$ (40,000.00)	\$ 161,200.00
Revenue Deficiency	\$ 4,861,800.00	\$ 5,925,600.00

The Board emailed a Notice of Hearing of the GRA, to interested parties on the AltaGas 2003/2004 GRA Phase II distribution list on February 17, 2005 and published it in the major Alberta newspapers on February 21, 2005.

The Board conducted the hearing for the Application during the period from July 18, 2005 to July 20, 2005, in Edmonton, Alberta. The panel assigned to the hearing consisted of R. G. Lock

(Presiding), G. J. Miller, and M. L. Asgar-Deen. Reply argument was filed on August 31, 2005, at which time the Board considered the record with respect to the Application to be closed. Parties and EUB staff that participated in the proceeding are listed in Appendix 1.

2 BACKGROUND

In Decision 2004-063, dated August 3, 2004, the Board approved the Memorandum of Agreement and Negotiated Settlement reached between AltaGas and its customers for the 2003/2004 GRA Phase I. However, consistent with the Board's approval to negotiate the 2003/2004 GRA Phase I, the Board expected AUI to file a full GRA for its next test year(s) in addition to having the 2005 GRA fully litigated.

In Order U2004-382, dated October 15, 2004, the Board approved AUI's compliance filing pursuant to Decision 2004-063, with the expectation that AUI would update its 2004 revenue requirement and revenue deficiency to incorporate the revised Alberta Corporate income tax rate, Generic Cost of Capital¹ results, and adjustments related to interim rates.

On April 12, 2005, the Board issued Decision 2005-029, which approved as final AltaGas' rates and riders, effective May 1, 2005.

3 ISSUES

The Board has reviewed the evidence in this proceeding, and considers that the main issues to be:

- Rate Base
- Necessary Working Capital
- Contributions in Aid of Construction
- Sales Revenue and Other Income
- Cost of Gas
- Expenses
- Depreciation Amortization Expense
- Income Taxes
- Cost of Capital

Any references to specific parts of the record are to assist the reader in understanding the Board's decision, but should not be taken as an indication that the Board did not consider the entire record as it relates to that issue. Further, any costs not specifically referenced in the Decision should be assumed to be approved as filed.

4 RATE BASE

AUI forecasted the mid-year net rate base at \$144,883,300 for 2005 and \$147,443,300 for 2006.² AUI submitted that its forecasts of rate base for the test years were reasonable and should be accepted by the Board.

¹ Refer to Decision 2004-052

² Exhibit 02-001 Schedule 5.1

4.1 Plant and Accumulated Depreciation

The Consumers Group (CG) took no issue with AUI's opening gross plant in service and accumulated depreciation amounts set out in the Application. The Board concurs that the opening balances appear reasonable.

The Company forecasted total capital expenditures in the amounts of \$12,476,900 in 2005 and \$9,517,000 in 2006.

The CG noted various examples where AUI's historic actual capital expenditures had been less than forecast and consequently argued that AUI overstated its forecasts. On this basis, the CG argued that AUI's capital expenditure forecasts were overstated. AUI countered this argument by noting that over the 2003/2004 GRA test period, its overall forecast was only out by 2.58 percent, or less than \$500,000 of expenditures that totaled \$19.2 million.

The Board acknowledges that AUI's forecast of total expenditures for 2003/2004 was not significantly different from the actual amounts for that period. While the Board finds such an overall statistic to be useful, it is of the view that an assessment of the reasonableness of forecast capital expenditures in the context of a GRA is best conducted by way of a detailed review of specific items that underpin the overall forecast. Accordingly, the Board will adopt the more detailed approach when reviewing AUI's forecast capital expenditures.

4.1.1 New Business

AUI's gross capital expenditures for new business in 2005 and 2006 were forecast to be \$3,910,000 and \$4,216,000 respectively, which excluded deductions for contributions and grants. The CG concluded that AUI's direct unit costs for new business were reasonable. The Board is satisfied that AUI's forecasts of capital expenditures for new business for 2005 and 2006 are reasonable in comparison to the actual 2003 and 2004 capital expenditures of \$4,735,400 and \$4,383,000, respectively.

4.1.2 Expansion

AUI forecasted one expansion project for 2005 that involved the acquisition of a portion of the assets of Orr Mineral Developments Ltd (Orr). AUI sought to include an amount of \$259,000³, in rate base to reflect the assets acquired from Orr. No expansions were forecast for 2006.

AUI argued that its net present value (NPV) analysis with respect to the Orr acquisition indicated that AUI could economically purchase the assets for a cost of \$260,267 without causing harm to existing customers. In the case of the Orr acquisition, AUI submitted that the customers of Orr received the gain on sale, and were held harmless. Further, the future revenues from former Orr customers would offset any need for an increase in rates for existing AUI customers caused by the acquisition. AUI was of the view that because its NPV analysis showed that no rate increase will result in the long run, and that reliability and safety concerns have been addressed, then "no harm" accrues to customers. AUI therefore submitted that the full acquisition cost should be allowed in rate base.

³ The net book value of the assets was \$35,197

The CG noted that in the first full year of the NPV analysis, revenues are forecast to be \$40,835 and expenses are forecast to be \$46,012. A crossover occurs in year 10 and revenues exceed expenses thereafter.⁴

The CG argued that the Orr system is 29 years old and will likely require significant replacements and increasing operating expenses before the end of the period reflected in the NPV analysis. Neither of these costs was reflected in the net present value analysis. In addition, the CG noted that AUI listed several concerns and deficiencies in the Due Diligence Review, the costs of which were not quantified.

The CG further submitted that AUI should not be allowed to include any amount in excess of net book value in rate base, consistent with the Board's determinations in Decision 2000-41, dated July 5, 2000.⁵

In considering the merits of including any asset in a rate base, the Board assesses the possibility of harm to customers. In Decision 2000-41 the Board stated that:

The Board has held that its discretion under essentially similar provisions of the GU Act must be exercised according to a "no harm" standard. More specifically, the Board has held that it must be satisfied that customers of the utility will experience no adverse impact as a result of the reviewable transaction.⁶ The Board considers that a similar principle applies when it is asked to approve transactions pursuant to Section 91.1(2) of the PUB Act and believes that guidance in the application of this principle can be found in other provisions of its governing legislation.⁷

In previous decisions, the Board has articulated two criteria in applying the no harm test. These can be summarized as (1) assessing the continuity of safe and reliable operation of the utility as a result of the transaction, and (2) assessing the impact to customers, financial or otherwise, from the completion of the transaction.⁸

With respect to the first criteria, the Board considers that the Orr acquisition will not have a significant impact on the continued safe and reliable operation of AUI. With respect to the impact to ratepayers, no party adduced evidence or argued that service levels would be negatively impacted by the Orr acquisition.

From a financial perspective, AUI's NPV analysis of the Orr acquisition suggests that customers would not be harmed. However, the Board notes with agreement the CG's submission that AUI's NPV analysis did not take into consideration the potential for increased maintenance and replacement costs associated with a 29 year old asset. Furthermore, AUI did not provide any quantifiable assurance that the concerns and deficiencies listed in AUI's Due Diligence Report will not be onerous to AUI and, therefore, to customers. It is also unclear whether the assumed consumption level of 138 GJ is appropriate when weighed against AUI's forecast of sales

⁴ Exhibit 13-010

⁵ Decision 2000-41, TransAlta Utilities Corporation, Sales of Distribution Business

⁶ See Decision U98084, NOVA Corporation, et al., Application for Regulatory Approvals in Connection with a Proposed Merger of NOVA Corporation and TransCanada Pipelines Limited (May 19, 1998), p.6; Decision U98097, Westcoast Energy Inc. et al., Sale of Shares in Centra Gas Alberta Inc. from Westcoast Energy Inc. to AltaGas Services Inc. (June 29, 1998), p.3; Decision U99102, supra, p.8

⁷ Decision 2000-41, p. 8

⁸ For example, see Decision 2002-069, pp 28-29, Decision 2003-098, p. 4, and Decision 2005-118, pp. 6-7

revenue for 2005 and 2006, which, for residential customers, was based on annualized normal usage of approximately 126 GJ.

As the CG indicated, the Board has, in other cases, denied requests for premiums, i.e., the excess amount paid over net book value, to be included in rate base. For example, in Decision 2000-41, the Board concluded the following with regard to premiums over net book value:

The Board notes UtiliCorp's statement that it does not intend to increase rate base as a result of this sale. The Board considers that, in order to keep customers whole in this transaction, it is vital that the premium paid by UtiliCorp does not make its way into rate base.⁹

However, such denials of premiums over net book value in recent applications have been in the context of a new utility entering the market and taking over the entire business of an existing utility. In those situations, the Board denied the inclusion of the premiums in rate base because there would have been a negative impact on customer rates if the premiums were included. The Board has been of the view that customers should not pay increased rates simply because one company takes over an existing utility.¹⁰ This is different from the current case of the Orr acquisition where AltaGas acquired these assets to expand its system.

Regardless, because of the previously-noted concerns with respect to AUI's NPV analysis, the Board is of the view that there is a reasonable possibility that customers may be financially harmed by the acquisition if the full difference between the acquisition price and the net book value of the Orr assets is included in rate base. Given this view, the Board is not prepared at this point to grant AUI's request to include the full acquisition costs of the Orr assets in rate base. However, the Board is prepared to include that amount in rate base that can be shown to conclusively result in no financial harm, which the Board believes may be greater than the net book value of the assets.

Therefore, the Board directs AUI in its compliance filing to:

- re-examine the use of the consumption level of 138 GJ per customer in its NPV analysis and adjust the consumption level if appropriate, and if the result remains at 138 GJ, then AUI must provide additional information which will assist the Board in understanding that result;
- quantify and explain all concerns and deficiencies contained in AUI's Due Diligence Report;
- re-examine why AUI did not forecast any replacement or increase in maintenance costs over the term of the NPV analysis and adjust for any conclusions reached which differ from the filed NPV analysis, and if the result remains unchanged, then AUI must provide additional information which will assist the Board in understanding that result; and
- provide further explanation regarding the assumptions in the NPV and file an excel spreadsheet (including formulas) of the NPV analysis and any other calculations that would enable the Board to verify all of the numbers in the NPV analysis.

⁹ Decision 2000-41, page 20

¹⁰ Decision 2002-038 Sale of Transmission Assets and Business to AltaLink; and Decision 2004-035 Sale of 100% of the shares of Aquila Networks Canada (Alberta) Ltd. (ANCA) to Fortis Alberta Holdings Inc. (Fortis Alberta)

Upon review of the information filed by AUI in its compliance filing, the Board will determine an appropriate amount to be included in rate base for the Orr acquisition.

4.1.3 System Betterment

AUI's capital expenditures related to system betterment were forecasted to be \$5,046,900 in 2005 and \$2,701,900 in 2006. AUI submitted that the 2005 forecast included a number of major projects that were in addition to the normal level of capital expenditures, the costs for which amounted to \$2,482,500, and accounted for a majority of the differences of the forecast betterments between 2005 and 2006. AUI also submitted that the forecast betterments for 2006 of \$2,701,900 were more in line with actual historical expenditures. Any issues identified by the CG regarding system betterment are referenced throughout this section.

4.1.3.1 Meter Replacements

AUI forecasted meter replacement expenditures in both test years at \$209,000. During the hearing the CG questioned the accuracy of AUI's forecasts for meters. Consequently, AUI revised its forecast for meters from \$209,000 to \$40,480 in each of the test years.¹¹ These revisions were made because AUI had incorrectly included some of the meters for new business in system betterments. The Board concurs with these revisions to meter replacement costs that reflect only system betterment expenditures.

The Board therefore directs AUI to reflect the revised forecast expenditures of \$40,480 for meter replacements for both test years in its compliance filing.

4.1.3.2 Regulator Replacements

AUI forecasted regulator replacement expenditures in both test years of \$99,000 in each of 2005 and 2006.¹² During the hearing, AUI also reviewed its forecast of regulator replacements of \$99,000 in each of 2005 and 2006.¹³ The CG noted that AUI had revised those forecasts down to \$16,500 in each of those years¹⁴, a reduction of \$82,500 in each year because AUI included some regulator replacements for new business in system betterment. The Board concurs with these revisions as they more appropriately reflect system betterment expenditures forecast for regulator replacements for the 2005 and 2006 test years.

The Board therefore directs AUI to reflect the revised regulator replacements forecast expenditures of \$16,500 for both test years in its compliance filing.

4.1.3.3 Superior System Replacements

The CG noted that the Superior System project was first identified in the 2003/2004 GRA where AUI forecasted \$167,500 for replacements.¹⁵ The CG questioned AUI about variances in excess of 20% in the 2003/2004 GRA. Given previous approvals and deferrals, the lack of urgency and that AUI is still examining alternatives to replacing the system, the CG submitted that the Board should not include any portion of the Superior System replacements as rate base additions in either 2005 or 2006.

¹¹ Refer to Exhibit 13-020

¹² Tr. p. 133

¹³ Tr. p. 133

¹⁴ Refer to Exhibit 13-020

¹⁵ 2003/2004 GRA, p. 6-3

AUI argued that the Superior System replacement concerned reliability of the system and service to customers and safety. AUI stated that the project was not done in 2003 and is under review.¹⁶ Although AUI did not specifically identify replacements to the Superior System in the Application, AUI did indicate that mains replacements included 16 km for PVC replacement at Westlock in each of 2005 and 2006 at a cost of \$365,500 and \$424,100, respectively.¹⁷ While AUI indicated that future implementation of new pipe locator technology could offset the need for the project, AUI submitted that there was a current need for this Superior System replacement and that expenditures of \$365,500 and \$424,100 were required in the respective test years.

While AUI has deferred the Superior System replacement in prior test years, the Board is hesitant to deny expenditures related to system reliability, service to customers, and safety. The Board notes that any uncertainty with regards to proceeding with this expenditure appears to be related to utilizing new technology that might eliminate the need for the project while preserving system reliability. The Board supports AUI's efforts to mitigate costs, and considers a full denial of AUI's forecast costs for the Superior System replacement is unwarranted. However due to the uncertainty associated with this project and the potential for efficiencies to come from new technology, the Board is prepared to approve 50% of AUI's forecast expenditures for the 2005 and 2006 test years.

The Board therefore directs AUI to revise its forecast for the Superior System replacement in its compliance filing to reflect 50% of AUI's forecast expenditures for the 2005 and 2006 test years.

4.1.3.4 Crossing Replacements

AUI forecasted expenditures for crossing replacements of \$419,000 in 2005 and \$221,000 in 2006. The 2005 estimate included \$85,000 for unidentified crossings and the entire \$221,000 in 2006 was unidentified.

AUI identified specific projects in 2005¹⁸ that represented a significant increase in crossing replacements over prior years. In 2006, AUI forecasted a return to crossing levels that existed in 2004¹⁹ and expected creek and river crossings of \$132,500 and other crossings of \$88,400, totalling \$221,000. AUI submitted that the amounts indicated for unidentified crossing replacements were reasonable in that the general provisions in both years were based on 2003 and 2004 actual experience.²⁰ AUI submitted that these forecasts should be allowed in full.

The CG noted that there was also one relatively large project included in 2004, the Yarrow Creek crossing.²¹ If that project was excluded from the base amounts for crossings, the CG submitted the average cost from 2001-2004 would have been about \$134,000 per year including overheads as compared to the \$190,000 to \$221,000 used by AUI. The CG considered that the unidentified crossing amounts did not reflect past history and submitted that the 2005 and 2006 forecasts for crossings should be reduced by \$70,000 per year.

¹⁶ Refer to response to information request (IR) CG-AUI-7(d)

¹⁷ Refer to response to IR CG-AUI-101(b)

¹⁸ Refer to response to IR CG-AUI-7(a)

¹⁹ In 2004 actual crossing replacements totalled \$226,723 (Refer to response to IR CG-AUI-101(g))

²⁰ Refer to response to IR CG-AUI-101(g)

²¹ Exhibit 13-024

The Board considers that AUI's forecast for crossing replacements appears reasonable for the 2005 and 2006 test years. Although the Yarrow Creek crossing increased the average costs of crossings from 2001-2004, the Board is not persuaded by the CG that excluding a large project in the 4-year average is appropriate. The Board notes that unidentified project expenditures for 2005 are comparable to 2003 and 2004 expenditures and that the 2006 forecast for crossing replacements, which includes only unidentified projects, is comparable with 2004 total expenditures. The Board therefore approves the proposed crossing replacements as filed.

4.1.3.5 Upgrading Projects

AUI forecasted pressure upgrading projects of \$152,300 in 2005 and \$106,000 in 2006.²² While AUI forecasted upgrading expenditures of \$50,000 in 2003 and \$58,000 in 2004, no upgrading projects were completed in 2003 or 2004.²³

The CG expressed concern over whether the other projects forecasted by AUI would proceed, given the experience in 2003 and 2004. The CG considered that because detailed costing had not been completed, there appeared to be some doubt that the Leduc-Falun and Pincher Creek uprates would be completed in 2005. Under the circumstances, the CG submitted that these two projects should not be included in rate base until 2006, and that 2005 additions therefore should be reduced by \$91,400 which represents the cost of these two projects. AUI submitted that the Leduc-Falun and Pincher Creek upgrading projects would go ahead in 2005, as these are required as a result of significant growth in the Pigeon Lake area and demand growth in the rural distribution system west and south of Pincher Creek, respectively.²⁴

The CG noted that the Drumheller and Pincher Creek Town uprates, forecasted to be completed in 2006 appeared to be contingent on the monitoring of pressures during the winter of 2005-2006²⁵ before the company determined "if upgrading was required prior to the winter of 2006-2007."²⁶ AUI stated that the current analysis forecasted lower than acceptable end pressures on the system in 2007.²⁷ Given the uncertainty regarding these projects, the CG submitted that 2006 rate base additions be reduced by \$106,000 and increased by the \$91,400 for projects originally forecasted for the 2005 test year.

The Board is cognizant that AUI had forecast upgrading projects for the 2003 and 2004 test period of \$50,000 and \$58,000, respectively, which were subsequently deferred. However, the Board agrees with AUI that there is no specific evidence on the record of this proceeding to suggest that these expenditures will not proceed in the 2005 and 2006 test years. Therefore, the Board approves AUI's forecast of upgrading projects for the 2005 and 2006 test years, but cautions that any future deferral of this project would likely result in denial of costs at AUI's next GRA.

4.1.3.6 Relocation Projects

AUI forecasted relocation project expenditures of \$426,400 and \$265,100 in 2005 and 2006 respectively. Subsequent to filing the Application, AUI revised the 2005 forecast for mains relocations from \$426,400 to \$484,300.²⁸

²² Application, Section 6.3.5

²³ Refer to response to IR CG-AUI-7(d)

²⁴ Refer to response to IR CG-AUI-7(f)

²⁵ Exhibit 13-025

²⁶ Exhibit 13-025

²⁷ Refer to response to IR CG-AUI-7(f)

²⁸ Refer to response to IR CG-AUI-7(h) and Exhibit 13-027

The CG noted that the revised amount included a general or unidentified provision of \$178,200, which exceeded 2004 actual expenditures for all relocations. The CG considered that the increase in identified projects should be offset by a decrease in unidentified projects and submitted that the 2005 forecast should remain at \$426,400.

AUI argued that the CG's request that the forecast of identified projects be offset by a decrease in unidentified projects was arbitrary and without substantive reason. AUI noted that the actual relocation costs for 2003 were \$452,085 and were \$38,385 greater than forecast.²⁹

The Board considers that relocation projects have fluctuated substantially from year to year.³⁰ Based on forecast variance to actual expenditures, AUI has either under or over forecast relocation projects in the range of approximately 8% to 38%. Based on AUI's past range of variance of forecast to actuals, the Board considers that AUI's original forecast for 2005 of \$426,400 falls within an acceptable tolerance range to the revised forecast, and therefore the original forecast appears reasonable. The Board considers that AUI's forecast of \$265,100 for the 2006 test year that encompasses only unidentified projects is reasonable when weighed against the average actual expenditures for 2003 and 2004 of approximately \$289,000. The Board therefore approves relocation project expenditures of \$426,000 in 2005 and \$265,100 in 2006.

The Board therefore directs AUI to include its original 2005 forecast of relocation project expenditures of \$426,400 in its compliance filing.

4.1.3.7 Capitalization of Overheads

The CG was concerned that it could not reconcile overhead costs that were capitalized as part of AUI's forecast of capital expenditures. Consequently, the CG considered that in future proceedings, AUI should provide complete details of direct and overhead costs for new plant and betterments in order to facilitate the review and testing of its capital expenditure budgets. The CG submitted that, in addition, AUI should be directed to demonstrate that capitalized overheads represent reasonable value for internally provided services and that detailed information pertaining to such amounts should form part of AUI's minimum filing requirements to avoid confusion in subsequent GRAs.

AUI considered that the CG had a lack of understanding about AUI's method of capitalizing overheads. In recognition of this, AUI agreed that it would provide more detail in its next GRA with regard to direct costs, capital overheads and related matters.

The Board agrees that there was some confusion regarding the capitalization of overheads and notes AUI's willingness to provide additional information on the matter in its next GRA. The Board therefore directs AUI at its next GRA to provide complete details of forecast overhead costs capitalized (including the basis on which they were determined) in order to facilitate the review and testing of its capital expenditure budgets.

²⁹ Refer to response to IR CG-AUI-7(d) p. 5

³⁰ Refer to response to IR CG-AUI-7(d) p. 5

4.1.3.8 Transmission Plant – Pipelines

AUI forecasted expenditures of \$2,208,300 for 2005 and \$486,000 for 2006 for reinforcement and looping projects, as well as expenditures of \$33,500 for 2005 and \$34,600 in 2006 for cathodic protection.³¹ AUI subsequently advised that it had determined that the \$176,000 expenditure forecast for 2006 related to the Southeast Reinforcement project would no longer be necessary.

The CG argued that AUI had a history of over-forecasting and suggested a 20% reduction per year for transmission plant pipelines. The CG noted that approved forecast expenditures for System Betterment Transmission Plant Pipelines in 2003 were \$628,500, but that no actual expenditures in that year occurred³² and that approved forecast expenditures for 2004 were \$1,051,400, which was \$614,944 higher than the actual expenditure of \$436,466.³³ The CG further noted that AUI's actual expenditures amounted to under 26% of the approved forecast amounts in the two year period.

AUI argued that CG's 20% adjustment was without justification and suggested that the CG was "cherry picking" line items in its capital expenditure forecast that appeared to be over-forecast, while ignoring other items that could be under-forecast.

The Board concurs with AUI's reduction of \$176,000 for the Southeast Reinforcement project. The Board considers that a reduction in AUI's remaining forecast expenditures for transmission plant pipeline appears to be warranted for the 2005 and 2006 test years, based on AUI's history of over-forecasting these expenditures. The Board therefore directs AUI to exclude the \$176,000 for the Southeast Reinforcement project and reduce its 2005 and 2006 forecasts for the remaining transmission plant pipeline expenditures by 25% in its compliance filing.

4.1.3.9 General Plant - Tools and Work Equipment

AUI forecasted Tools and Work Equipment expenditures of \$230,000 and \$154,000 in 2005 and 2006, respectively.

The CG expressed concern with these forecasted amounts for a number of reasons. The average of the expenditures in this category over the previous 5 years was \$102,000.³⁴ Further, comparisons to prior forecasts revealed that the company had spent amounts lower than forecast. The CG noted that this under spending amounted to approximately \$161,000 over 2003 and 2004.³⁵ Based on the above, the CG submitted that the Board should allow no more than \$250,000, spread over the two test years, as opposed to the total forecast of expenditures of \$384,000.

AUI submitted that three major items³⁶ was the reason the expenditures for tools and work equipment for 2005 exceeded the actual amounts over the last five years by approximately \$125,000. The forecast increase in expenditures in 2006 over the previous five-year actual amounts was attributed mainly to the need for Global Positioning System (GPS) equipment at a

³¹ Exhibit 02-001, Application pp. 10-11

³² Exhibit 02-008, CG-AUI-8(a) p. 2

³³ Exhibit 02-008, CG-AUI-8(a), p.2; T2, p. 0167, line 13, p. 0168, line 7

³⁴ Tr. 2 p. 233 line 17 to p. 234 line 3

³⁵ Tr. 2 p. 235 line 13 to p. 236 line 5

³⁶ A gas chromatograph, new line stopping equipment, and a shoring cage

cost of \$49,000. AUI argued that it had established that these expenditures were required in the test years.

The Board agrees with the CG's argument that yearly averages offer insight into the reasonableness of forecast costs for specific line items, but considers that the Board must also take into account specific work activity or required expenditures. The Board considers the 2005 increase to be reasonable, based on AUI's purchase of the three major items referenced above. The Board also considers that the 2006 increase over the previous five-year actuals appears to be justified by the purchase of GPS equipment. The Board therefore approves the forecasts for 2005 and 2006 as filed.

4.1.3.10 General Plant - Structures and Improvements

AUI forecast expenditures of \$535,500 and \$278,000 for 2005 and 2006, respectively, for structures and improvements.

The CG submitted that there were no business cases for the following:

2005 Capital Projects	>\$50,000
HVAC Upgrade	\$210,000
Upgrade Boilers	\$90,000
Stettler Shop Addition	\$76,000
2006 Capital Projects	>\$50,000
Bonnyville Office	\$250,000

The CG recommended that in all future rate applications, the Board direct AUI provide, for all capital expenditures over \$50,000, business cases that contain at least the following information:

- a detailed justification including demand, energy, and supply information (need assessment);
- a breakdown of the proposed cost;
- the options considered and their economics (including NPV analyses, if applicable);
- the need for the project in the test year; and
- the impact of deferral.

According to the CG, the above recommendation was consistent with the Board's findings in Decision 2004-069, dated August 24, 2004.³⁷ Consistent with Decision 2004-069, the CG submitted that the proposed capital expenditures for structures and improvements be reduced by 15%, amounting to a reduction of \$80,350 in 2005 and \$43,200 in 2006.

AUI submitted that, with respect to the requirement to file business cases to support major capital expenditures, it was not opposed to any procedure that the Board may require to improve the regulatory process. However, AUI submitted that it were not sufficiently staffed to significantly increase the detail of filings and would likely require additional staff and capital to meet new requirements. AUI submitted that the Board had never required AUI to file business

³⁷ Decision 2004-069, pp. 58-59

cases to support capital expenditures in the past and accordingly, AUI should not be penalized for not filing business cases as part of the Application. AUI considered that it had shown that the capital expenditures related to structures and improvements were required and should not be reduced by 15%.

The Board remains of the view that the onus is on a utility to justify its expenditures, with business cases being a preferred means of meeting that onus. The size of a utility and the ability to meet the Board's requirement for business cases must be weighed against the added cost to customers and resulting added value. The Board, however, is not persuaded by AUI's argument that due to the Company's size, a reduced standard or onus should be applied when evaluating AUI's GRAs. In addition, the Board notes that the requirement for business cases is not new. In Decision 2004-069 the Board made the following observations:

Clearly it is the applicant's responsibility to justify its application in any GRA. In Decision 2003-100 the Board referred to its requirements for business case analyses in Decisions 2000-9 and 2001-97 and stated that it is the applicant's responsibility to justify its application through the traditional regulatory process and to thoroughly and adequately explain individual budget items. Consistent with these requirements, the Board expects NGTL to provide the following:

- a detailed justification including demand, energy, and supply information;
- a breakdown of the proposed cost;
- the options considered and their economics; and
- the need for the project.

The Board considers that the requirements listed provide minimum criteria to be adopted by NGTL when justifying the merits of capital projects in future applications.

.....

The Board considers the unavailability of business cases to be problematic, as the lack of fundamental analysis limits the understanding of the interveners and the Board in respect of the proposed projects and the underlying economics, options, and justifications for the projects. The Board considers that it does not have sufficient information to approve the capital expenditures as submitted.

.....

The Board considers it appropriate to apply a reduction to capital expenditures in this case in line with certain reductions it imposed in Decision 2003-100. The Board therefore directs NGTL to reduce its 2004 test year forecast for capacity capital spending by 15% across the board. Additionally, the Board directs that all capacity capital expenditures be adjusted for their appropriate in service dates.³⁸

The Board also notes that AUI has negotiated its last two Phase I GRAs in full or in part. Therefore, the Board did not previously require AUI to justify specific costs due to the understanding that any settlement was based on an agreement between the parties. The Board

³⁸ Decision 2004-069, pp. 58-59

considers that detailed business cases to justify its business expenditures of over \$50,000 would be of assistance and directs AUI to file detailed business cases with its next GRA.

As a result of AUI failing to justify its proposed capital expenditures to structures and improvements, the Board considers a reduction of 15% on AUI's costs is warranted. Therefore, the Board directs AUI to include a 15% reduction to its forecast structures and improvements expenditures for both test years in its compliance filing.

4.2 Necessary Working Capital (NWC)

AUI forecasted NWC requirements of \$1,467,300 and \$1,444,400 for 2005 and 2006, respectively. During the hearing AUI decreased NWC requirements to \$1,167,100 for 2005 and \$1,145,700 for 2006. The decreases resulted from reductions in the timing of short-term incentive plan (STIP) payments.³⁹ The revised forecasts represented more than a 50% reduction from the forecast allowed NWC requirements for 2004 of \$2,915,700. The elements making up NWC include: cash working capital, operating and maintenance inventory, employee advances, deferred customer accounting, EUB special deposit, and deferred regulatory.

4.2.1 Operations and Maintenance (O&M) Inventory

AUI included \$200,000 for O&M inventory in each of 2005 and 2006.

The CG, based on an average year-end amount of \$173,675 derived from actual year-end inventories for the years 2000 through 2004,⁴⁰ argued that that O&M inventory was overstated by approximately \$25,000 for each of the test years. The CG further submitted that as AUI did not provide evidence to support that its forecast was reasonable, O&M inventory used for the purpose of calculating NWC should be set at \$175,000 for each of 2005 and 2006.

AUI noted that for NWC purposes O&M inventory was based on the average of the opening and closing balance for a year (the mid-year balance), not the year-end balance, and that the actual O&M mid-year inventory balance for 2003 was \$190,750 and for 2004 was \$184,500. Notwithstanding there was a decrease from 2003 to 2004, AUI submitted that it actually experienced increasing expenses of \$10,000 to \$20,000 each year and expected the expense to continue increasing. AUI also noted that the 2005 forecast amount was \$10,000 above the 2003 actual amount.

For purposes of determining NWC, the use of a mid-year balance is appropriate. AUI stated that O&M inventory was based on the 2003 actual ending balance being maintained through 2005 and 2006.⁴¹ The Board accepts this premise. Using those balances for 2005 and 2006 and the actual closing balance of \$170,185 for 2004, the Board considers that the mid-year O&M inventory balance for the test years would amount to approximately \$185,000 and \$200,000, respectively. The Board thus directs AUI to adjust its 2005 amount for O&M inventory accordingly for purposes of its compliance filing.

³⁹ Exhibit 13-012

⁴⁰ Refer to response to IR CG-AUI-29(a)

⁴¹ Refer to response to IR CG-AUI-29(c)

4.2.2 Hearing Costs

In its deferred regulatory costs for 2005, AUI included an amount of \$20,000 for its 2003/2004 GRA Compliance Filing, Phase I. The CG noted that in Utility Cost Order 2005-011, dated February 17, 2005, the amount approved by the Board was \$4,069.49. AUI agreed that the amount in the cost order was correct. Accordingly, the Board directs AUI to make the appropriate adjustment in its compliance filing.

4.3 Contributions in Aid of Construction

The Board has reviewed AUI's past record of forecasting contributions in aid of construction and determined that any variance to actual amounts were adequately explained by AUI.⁴² The Board also notes that the CG accepted AUI's opening accumulated contribution amounts on the forecast contribution for the test years. The Board is satisfied with AUI's forecasting history regarding contributions in aid of construction and approves AUI's forecast contributions as filed.

5 SALES REVENUE AND OTHER INCOME

AUI submitted that customer usage for residential, rural and commercial categories will decline over the test years. The main reasons for this were:

- New natural gas appliances were significantly more efficient than older appliances. The appliances associated with new service consumed less natural gas. Further, usage at existing service sites declined, as customers replaced appliances that had reached the end of their useful life.
- Existing customers were implementing energy conservation measures to reduce their overall energy consumption, including their usage of natural gas. Such measures included improving building insulation and maintaining lower building temperatures.
- Existing customers were turning to other energy sources to replace natural gas consumption. Alternative energy sources included wood and coal. Other alternatives, such as geothermal and solar were also emerging.

AUI compared the 2005 and 2006 forecasts to trended forecast customer usage made at the time of the Application and to actual normalized results from 2002 through 2004 for the residential, rural and commercial customers. Based on an analysis of the trends and historic averages, AUI submitted that the forecast usages were reasonable.⁴³ AUI provided the following customer usage of consumption forecast in gigajoules (GJ).

	2005	2006
Residential	126.17	125.54
Commercial	612.45	600.21
Rural	185.23	183.38

In the Application, AUI forecasted irrigation energy deliveries of 120,711 GJ for each of 2005 and 2006.⁴⁴

⁴² Refer to response to IR CG-AUI-35(g)

⁴³ See CG-AUI-37(c) for a detailed explanation of the forecasting method

⁴⁴ Application Exhibit-02-001, Schedule 10.1

The CG submitted that it was concerned that the sales forecasting methods utilized by AUI with regard to the Residential, Commercial and Rural classes were not accurate.

AUI provided its forecast 2004 Normalized Actuals in the graphs on pages 2 and 3 of the response to CG-AUI-112 as follows. Also shown were the 2004 Normalized Actuals calculated in Exhibit 13-005.

Class	2004 Forecast Unit Consumption (GJ/yr)	2004 Normalized Actual Unit Consumption (GJ/yr)
Residential	126.8	128.2
Commercial	625.0	637.0
Rural	187.1	187.0

Regarding this table, the CG stated that AUI under-forecasted the Commercial unit consumption for 2004 by a full 1.9% (637.0 versus 625.0) and under-forecasted the Residential consumption for 2004 by 1.1% (128.2 versus 126.8). The CG proposed that the 2004 actual normal values be used as the basis for the calculation of the forecast 2005 and 2006 use per customer for the Different Classes instead of using the 2004 forecast. The CG noted that while the 2004 forecast use per customer for the Rural class appeared to be close to the level of the 2004 actual normal value, for the sake of consistency with the Residential and Commercial classes, the 2004 actual normal use per customer for the Rural class should form the base for the calculation of the forecast 2005 and 2006 use per customer for the Rural class. The CG considered the AUI annual irrigation forecast that was based on 5 years of actual data as reasonable for the 2005 and 2006 test years.

An analysis of AUI's revised trend line graphs provided in argument, improved efficiency of residential furnaces/appliances, and conservation advances lead the Board to conclude that AUI's 2005 and 2006 forecasts of consumption per customer for the rural and residential rate classes are reasonable. For both rate classes, the forecast consumption per customer is above the 5-year and 3-year actual trend line thereby suggesting that AUI's forecast of consumption for rural and residential customers should not lead to a significant windfall of excess revenue strictly to the benefit of shareholders. However, AUI's forecast of consumption per commercial customer is below the trend line graphs provided by AUI, and therefore the Board considers an upward adjustment to AUI's forecast consumption per commercial customers is warranted. The Board considers a forecast consumption of 630 GJ per commercial customer for both the 2005 and 2006 test years is more in line with AUI's 5-year and 3-year trend lines.

With regards to irrigation customers, the Board agrees with the CG that AUI's forecast of 120,711 GJ for the 2005 and 2006 test years appears reasonable.

The Board therefore approves AUI's forecast consumption per customer for rural, residential and irrigation customers, but directs AUI to increase per customer usage for commercial customers to 630 GJ, and reflect this direction in its compliance filing including a breakdown of revenue forecast by rate class compared against a similar breakdown from AUI's original filing.

5.1 Penalty Revenues

AUI forecasted penalty revenues in 2005 and 2006 of \$90,000 and \$54,000 respectively. Due to discrepancies in the determination of the penalty revenues forecasted in the original filing, the

Company re-forecasted 2005 and 2006 penalty revenues.⁴⁵ Based on 2004 actual results, it appeared the 2004 Allowed Forecast was a high estimate. Compared to the 2004 Actual penalty revenue of \$77,700, the CG argued that the revised 2005 and 2006 forecasts appeared more reasonable. The CG reviewed the revised computations and concurred with the company's re-calculations. The CG submitted that the 2005 forecast be reduced by \$14,521 and the 2006 forecast be increased by \$22,124. In CG-AUI-44(f), AUI agreed with these revisions.

The Board concurs with the Company's revisions of the penalty revenues forecast and directs AUI to reduce its 2005 forecast of penalty revenues by \$14,521 and increase its 2006 forecast by \$22,124 in its compliance filing.

6 COST OF GAS

AUI's cost of gas is subject to the procedures approved by the Board concerning the operation of a deferred gas account (DGA) and the recovery of those costs through the regulated gas cost recovery rate (GCRR).⁴⁶ Under the terms of the DGA procedures, which are set out in Decision 2001-75, dated October 30, 2001, and, more particularly to AUI, in Decision 2002-036, dated March 21, 2002, AUI neither profits nor loses from the sale of gas to default supply customers through the GCRR. AUI determines its GCRR on a monthly basis. Costs for gas purchases are forecast in the month prior to implementation and reconciled with actual costs over a three month period. Non-commodity costs related to gas purchases are included in the DGA based on an annual forecast and subsequently reconciled annually with actual costs incurred.

Decision 2001-75 provided that "the following direct costs should be transferred from utility cost of service to the GCRR through interim rates:

- gas purchase costs;
- imbalance costs net of imbalance revenue;
- transportation costs upstream of the utilities' pipeline systems;
- GCRR portfolio management and administration costs;
- transportation receipt costs;
- GCRR gas supply-related bad debts; and
- DGA balance carrying costs."⁴⁷

Inclusion of these costs in the DGA for purposes of determining the GCRR was confirmed in Decision 2002-036.

6.1 Transportation Costs

The CG submitted that all transportation costs should form part of AUI's revenue requirement. By removing transportation costs from the cost of gas the CG submitted that:

- AUI's cost of gas would be made competitive with that of retail suppliers in that a level playing field in the competitive retail gas industry would be provided., and allow for

⁴⁵ Exhibit 02-008-014 AUI 1378000 IR Responses (CG1) CG-AUI-44(f) 2005-04-29.xls

⁴⁶ The gas rate that is regulated by the Board is referred to as a default rate tariff (*Gas Utilities Act, RSA 2000, Chapter G-5*); customers acquiring gas under this rate are referred to as default supply customers.

⁴⁷ Decision 2001-75, p. 81

AUI's GCRR to be more equivalent to rates of other retail gas suppliers whose cost of gas does not include transportation costs.

- All of AUI's customers would be subject to charges for transportation costs, thereby preventing a subsidization of transportation customers, who purchase gas from a retail supplier, by default supply customers, who are charged the transportation costs in the GCRR
- The accuracy of AUI's forecasts, which have the potential of over-estimating demand, would be improved and be subject to full scrutiny by intervenors.

The CG considered that AUI did not adequately support its forecast of transportation charges for 2005 and 2006. The CG submitted that the over-forecasting could cause AUI to be in a conflict of interest in that one of its transportation service suppliers was an affiliated company. The CG also submitted that if its recommendation was accepted and the transportation charges are included in revenue requirement the forecasts for the respective years should each be reduced by 10%.

AUI did not object to separating transportation costs from the cost of gas but only on the condition that the costs will be subject to a deferral account, given that the actual costs presently incurred are recovered through the DGA. AUI thus submitted that the current Board-approved method of flow-through recovery of transportation costs continue.

AUI argued that separating transportation costs from the cost of gas, and thereby effectively reducing the GCRR, may inhibit development of the retail market in its service territory. Noting that only about 400 customers, or less than 7/10ths of one percent, out of over 60,000 customers, are served by retail supply, AUI submitted that subsidization, if any, of retail customers by default supply customers with respect to transportation costs would be very small.

AUI disagreed that removing transportation costs from the cost of gas would result in increased intervenor scrutiny of transportation costs. The DGA procedures in place provide for review of AUI's monthly GCRR filings by the Board and an opportunity for intervenors to review them. AUI noted that related inter-affiliate transactions fall under the jurisdiction of the Board's audit and compliance group and submitted that there is ample opportunity to determine the reasonableness of affiliate costs. Accordingly, AUI considered that the issue was not material to the Application.

AUI submitted that its forecasts of transportation costs for the test years were based on historic results and were reasonable given the current approved methodology for applying these costs in the GCRR. None-the-less, given the Board approved method of treating transportation costs as part of the GCRR made the specific dollar amount forecast somewhat of a moot point. AUI considered that a move to shift transportation costs to revenue requirement was a significant departure from procedures established in the generic gas cost methodology proceeding that led to Decision 2001-75.

As transportation costs were made an integral part of the DGA methodology, the Board concurs that they should not be removed from the cost of gas. Instead, transportation cost should be subject to a forecast to be included in AUI's revenue requirement. However, to the extent that transportation costs pertain to the delivery of gas to a customer served by a retail supplier, The Board considers that such costs should not be included in the determination of the GCRR.

The Board notes, and accepts, AUI's intention to charge retail suppliers with the appropriate portion of transportation costs associated with their supply. In this regard, the Board directs AUI to provide sufficient details of transportation costs in its monthly GCRR filings, beginning January 2006, that would allow the appropriateness of actual transportation costs included in the GCRR to be determined.

The Board also notes that if an interested party has a concern with transportation costs, or any other costs, that have been included in the determination of a GCRR, Decision 2001-75 provided for a 30-day review period following the filing of each monthly GCRR in which interested parties can raise their concerns.

6.2 Non-commodity Costs

The CG took issue with the substantial fluctuations in the 2003 and 2004 allowed forecasts and 2005 and 2006 forecasts for non-commodity costs. The CG disagreed that the variances in non-commodity costs were mainly due to fluctuations in forecasts of bad debts, noting that a review of the percent changes from 2003 through 2006 showed no correlation whatsoever between the change in non-commodity costs and the change in bad debt expense.

AUI agreed that the change in non-commodity costs was not explained by fluctuations in bad debts. AUI, however, provided an explanation of the variances, stating that the year-over-year variation was the result of the inclusion of the carrying costs related to the budget payment plan in 2005 and 2006, which costs did not appear in prior years, and the magnitude of adjustments to the DGA for the penalty revenue credit and the carrying costs related to gas supply charges.

The CG submitted that AUI provided little useful information regarding non-commodity costs. The poor forecasting and lack of adequate provision of back-up information reflected poorly on AUI's overall forecasting proficiency. Consequently, the CG proposed that these costs should be forecast on a three-year rolling average basis to smooth out the affects of basing forecasts on actual data.

The Board notes that in its application leading to Decision 2002-036, AUI included the following procedure relating to the monthly non-gas direct gas supply components (non-commodity costs) included in its GCRR/DGA methodology:

6.2 Use Previous Year's Actual as Current Year Estimate

Every year thereafter [2002], in the February GCRR filing the Company proposes that it revise the estimated monthly allocation to the DGA. The updated estimate will be calculated using the monthly average of the previous year's actual results. (The DGA will also be updated in February to "true-up" the previous year's Actual-to- Estimate variance.)

6.3 Once per Year Adjustment to Actual

The final dollar value of non-gas supply components applied to the DGA would be based on the actual amounts per the Company's annual audited financial statements. The share of the dollar value allocated to the deferred gas account would only be the amount related to the GCRR.

...⁴⁸

⁴⁸ Mock GCRR Filing and Additional comments In Accordance with Alberta Energy Utilities Board Decision 2001-75 Directive Section 5.1.2, p. 12 of 14

The Board accepted AUI's proposal and approved its methodology for the treatment of non-gas supply costs in the determination of its GCCR⁴⁹ and considers that the methodology remains appropriate. Therefore, the Board rejects the CG's proposal to use a three-year rolling average to forecast non-commodity costs.

7 EXPENSES

AUI forecasted expenses for the 2005 test year at \$17,951,900 and for 2006 at \$18,762,500. The forecast for 2005 was an increase of \$2,194,900 over the 2004 allowed amount. Over the 2004 actual amounts, the increase is slightly smaller at \$2,099,100.⁵⁰ The increase in forecast expense arose from increasing regulatory expense, salary and benefit expense, and professional fees.⁵¹ From 2005 to 2006 expenses were forecasted to increase by a further \$810,000.

AUI submitted that the Board should take a broad practical approach to the test year forecasts, rather than focusing on a line-by-line review of allowed versus actual expenses. Further, the process of forecasting expenses was not an exact science and overall the Company did a fair and reasonable job of forecasting expenses. AUI considered that although in the 2003/2004 test years, it may have over forecast some individual expense line items, as pointed out by interveners, but overall in 2003 and 2004, AUI spent more on expenses than forecast.

The Board is primarily concerned with the overall assessment of expenses and any related variance, which must be justified by the underlying line items. Any significant variances of line items could lead to significant variances from test year to test year, thus impacting customers. A balanced approach must be considered when weighing the overall assessment versus individual line item scrutiny.

7.1 Leases and Crossing Rentals

A summary of the actual and forecast expenditures in this area is as follows:⁵²

2001	\$37,425	Actual
2002	\$43,479	Actual
2003	\$44,350	Actual
2004	\$39,110	Actual
2005	\$45,800	Forecast
2006	\$46,716	Forecast

With respect to Crossing Rentals, the CG submitted that AUI showed that in 2004, there was a reduction of 12% over 2003. However for 2005 there was an increase over 2004 of 17% and a further increase over 2005 amounted to 2% in 2006.

⁴⁹ Decision 2002-036, p. 3

⁵⁰ Exhibit 02-006-002 Schedule 12.1

⁵¹ Exhibit 02-001 p. 27

⁵² Refer to response to IR BR-AUI-1 and GRA, Schedule 12.1, L8

The CG requested the basis for forecasting 2005 and 2006, and AUI stated:

In forecasting the 2005 and 2006 payments, the Company used general inflation factor of 2.1% as per the October 2004 Economic Consensus. For further detail please refer to the response to CG-AUI-100 (g). As noted above, the 2005 projected increase is 17%, significantly in excess of the 2.1% noted in CG-AUI-55 (d). If a 2.1% increase, is enforceable, the 2005 forecast amount (going from 2004) is \$39,930, a reduction of \$5,870 (\$45,800 - \$39,930). Similarly, if a 2.1% increase is employed for 2006 over 2005, it would be \$40,768 (compared to \$46,716 forecast in 2006 in CG-AUI-55 (c), a reduction of \$5,947 from the amount forecast in 2006.⁵³

Based on the foregoing, the CG submitted that the revenue requirement in these categories should be reduced by \$5,870 and \$5,947 in 2006.

AUI submitted that the forecast increases in 2005 and 2006 were based on 2003 levels and were directly related to the amount of activity AUI was forecasting in its service territory as reflected in other expense areas, as well as capital expenditures, including crossings. Accordingly, the forecast for leases and crossing rentals in the test years was more than reasonable and the CG's argument should be rejected.

The Board notes AUI's submission that 2003 is more indicative of a typical year of work activity, and therefore a 2% increase over this base year in the Board's view seems reasonable. The Board also considers the recommended changes of the CG to be immaterial. The Board is satisfied, and agrees with AUI, that forecast increases in 2005 and 2006 are reasonable and therefore are approved as filed.

7.2 Maintenance Contracts

A summary of the actual and forecast expenditures in this area are as follows:⁵⁴

2001	\$326,689	Actual
2002	\$338,182	Actual
2003	\$379,408	Actual
2004	\$311,730	Actual
2005	\$456,284	Forecast
2006	\$465,410	Forecast

The Company developed its forecast for maintenance contracts for 2005 through a detailed analysis by vendor.

The CG submitted that it was concerned about the Company's forecasting ability in this area. In both 2003 and 2004, there was a significant over-forecast. As discussed at the hearing,⁵⁵ the over forecast for 2004 was \$58,468 or 13% and in 2004, it was \$202,217 or 39%. Over these two years, AUI had over-collected \$260,685 from customers. While there were several reasons to support the significant overstatement in forecasts for 2003 and 2004, the CG noted that in both of these years, AUI purchased maintenance agreements for "new equipment warranty negating the need to purchase maintenance agreements for the equipment." In 2005, such unnecessary

⁵³ Refer to response to IR CG- AUI -55(d)

⁵⁴ Refer to response to IR BR-AUI-1 and GRA, Schedule 12.1, L9

⁵⁵ Tr. pp. 258-260

purchase accounted for \$26,000 of the variance, while for 2006, it accounted for \$21,000 of the variance.

Given the history of significant forecasting inaccuracy in this area, the CG submitted that the Board should effect a 10% reduction in the forecast capital expenditures for each of 2005 and 2006.

AUI conceded that a reduction in the area of maintenance contracts was required in the 2005 forecast to correspond with the fact that the implementation of the work management system was deferred from 2004 to 2005.⁵⁶ As a result of the postponement, maintenance costs would not be incurred until the year after implementation and therefore the first \$50,000 would not be incurred in 2005 as originally forecast.

The Board concurs with the \$50,000 reduction in 2005 resulting from the absence of maintenance contracts due to the deferral of the implementation of the work management system from 2004 to 2005. Further, the Board directs AUI to reduce its forecast of maintenance contracts for both test years by an additional 10% based on its record of over-forecasting. The Board directs AUI to file these revisions in its compliance filing.

7.3 Bad Debts

AUI's bad debts expense is as follows:⁵⁷

2001	\$65,769	Actual
2002	\$84,012	Actual
2003	\$99,718	Actual
2004	\$89,560	Forecast
2004	61,686	Actual
2005	\$110,000	Forecast
2006	\$120,000	Forecast

The CG noted there was a significant increase in bad debts expense forecasted for the test years. According to the CG, in 2005, AUI expected increased bad debts of \$48,314 or 78% and in 2006 a further increase of \$10,000 or 9%. Further, AUI's forecast for 2004 was significantly over-stated by \$27,874 or 28%. The CG's concern was that AUI used this over-stated 2004 forecast on which to base its 2005 and 2006 bad debts expense. Exhibit 013-006 showed that bad debts, as a percent of total sales, had been in the range of 0.06% to 0.35% between 2001 and 2004. The CG stated that the average for these years was 0.23%, whereas the ratio used by AUI for 2005 was 0.33% and for 2006 was 0.36%. The CG recommended that the Board use the average bad debt to sales ratio experienced in the period 2001-2004 of 0.23% to determine the appropriate expense for the test years. CG felt the bad debts expense charged to expense (i.e. the non-gas or GCRR component) should be reduced by \$33,562 in 2005 and \$43,660 in 2006.

The Company, in response to CG-AUI-58(b), explained that "Bad Debt expense forecast for 2005 and 2006 was based on the 2003 actual bad debt incurred." The Company submitted that bad debt expense would likely increase over the test years at the amounts forecast.

⁵⁶ CG-AUI-13(b)

⁵⁷ Refer to response to IR BR-AUI-1 and GRA, Schedule 12.1, L9

The Board is of the view that AUI has failed to justify an increase in bad debt expense beyond referencing 2003 actual as a base year for the 2005 and 2006 forecasts. The Board concurs with the CG that AUI should use the average bad debt to sales ratio experienced in the period 2001-2004 of 0.23% to determine the appropriate expense for the test years. Thus the Board directs AUI to reduce its bad debts expense by \$33,562 in 2005 and \$43,660 in 2006, and file this reduction in its compliance filing.

7.4 Insurance

The CG noted that the Company stated that the insurance premiums were expected to be stabilized starting in 2005. This stabilization was confirmed by the witnesses.⁵⁸ Arguing that AUI's forecasts were over-stated for both 2003 and 2004, and that AUI had used the 2004 Allowed forecast as a base to forecast the expense for the test years, the CG submitted that the forecast for 2005 should reflect no more than a 5% increase in each of 2005 and 2006, therefore a reduction of \$65,122 and \$16,108 should be applied in 2005 and 2006, respectively.

AUI indicated that it overstated the 2005 forecast, whereat insurance expense should have only increased by 10% not 13% as indicated.⁵⁹ This translated to reductions in the 2005 forecast by \$27,400 and the 2006 forecast by \$29,200.⁶⁰ AUI argued that this was an example of the type of issue raised by the CG where relatively minor variances obscured the reality that overall forecasting by the Company had been very close to actual results. However, AUI argued that there was no evidence to support the CG's recommendation.

The Board concurs with the CG that AUI's forecasts were over-stated for both 2003 and 2004. Based on the stabilization of insurance premiums, the Board considers that a 5% reduction to insurance is warranted despite the minimal impact to customers. The Board therefore directs AUI to reduce its 2005 and 2006 insurance expense by 5% in its compliance filing.

7.5 Audit Fees/Professional Fees

In 2005 and 2006, the Company forecasted total audit fees of \$99,000 and \$206,000, respectively, which represent an \$8,400 increase in 2005 over 2004 approved amounts and a \$107,000 increase in 2006 from 2005 forecast amounts. The forecasted increase in 2006 related to additional audit costs in respect of anticipated changes to accounting standards and legal requirements for internal control over financial reporting documentation (new reporting requirements).⁶¹

The CG noted that that full certification necessary for the new reporting requirements was not required until June 2008, and the external audit work would not be required until 2008. Therefore, the CG submitted that the forecast 2006 audit fees be reduced to \$99,000, the same level as that for 2005.

AUI anticipated that the legislation for the new reporting requirements, which was currently being developed by the Ontario Securities Commission and would impose requirements similar to the Sarbanes-Oxley legislation in the United States, would be implemented in 2005. AUI, with advice from its external auditors, forecasted that the additional audit fees of \$107,000 in 2006

⁵⁸ T2 p. 273 lines 20 – 22

⁵⁹ T2 p. 274

⁶⁰ Ref. CG-AUI-52(d)

⁶¹ Refer to response to IR CG-AUI-130(m)

would be necessary to undertake additional audit procedures to ensure that AUI was complying with the new requirements.

The Board concurs with AUI that an increase in audit costs is warranted in order for AUI to comply with the demands for the new reporting requirements. However, the Board notes that forecast expenditures associated with increased audit fees for the new reporting requirements are subject to a significant degree of uncertainty. The Board therefore directs AUI to establish a deferral account (Additional Audit Fee Deferral Account) to capture the differences between forecast and actual amounts incurred in 2006 for the additional audit fees associated with the new financial reporting requirements. The Board further directs AUI, at its next GRA, to provide a reconciliation of the Additional Audit Fee Deferral Account balance and demonstrate that the actual costs incurred by AUI related to increased audit fees were reasonable.

In light of the establishment of the Additional Audit Fee Deferral Account, the Board approves normal audit fees of \$99,000 for both the 2005 and 2006 test years, and the additional audit fees \$107,000 in 2006.

With respect to professional fees, AUI forecasted \$278,100 in 2005, which was an increase of \$137,900 from 2004 allowed amounts, and \$182,400 in 2006⁶² including an amount of \$100,000 in 2005 for the new reporting requirements. Similar to the increases in audit costs, these professional fees are necessary for compliance. AUI advised that it had retained Meyers, Norris, Penny LLP, Chartered Accountants, to document and test internal controls by the end of 2005. During the hearing, AUI revised its 2005 forecast for the new reporting requirements from \$100,000 to \$428,000 and included an additional amount of \$25,000 for 2006.⁶³

Because of the magnitude of the new reporting requirements and given the unpredictable nature of the costs, the Company requested that the Board allow the set up of a deferral account and the amortization of these forecast costs over five years (2005-2009). The deferral account balance could then be reconciled with actual costs at the next GRA.

The CG argued that the revised forecast appeared to be a selective update to the forecast of operating expenses and submitted that it should not be accepted in isolation. The CG did not agree with AUI's proposal to implement a deferral account because of the magnitude of the CEO/CFO certification costs. The CG submitted that this constituted new evidence filed in Argument and therefore, the proposal should be rejected.⁶⁴

The Board recognizes that AUI is required to comply with the new reporting requirements. However, the exact timing of costs associated with compliance is uncertain, and related forecasts seem highly susceptible to variability. Although the use of a deferral account was not introduced by AUI as original evidence in the proceeding, the Board considers that utilizing a deferral account mitigates the risk to both customers and AUI when forecasts are highly volatile and beyond the reasonable control of the utility. The Board therefore agrees with AUI that deferral account treatment is appropriate, but only with regard to forecast costs amortized over the 2005 and 2006 test years, which are to be updated to actual costs at AUI's next GRA. Any

⁶² Refer to response to IR CG-AUI-62(o)

⁶³ Exhibit 13-016

⁶⁴ CG Reply, page 11

determination regarding costs of compliance beyond the test years will be reviewed at AUI's next GRA.

Due to the uncertainty associated with AUI's forecast costs for the new reporting requirements, the Board is only prepared to approve \$264,000 in 2005 for related professional fees, which is the mid-point between AUI's original forecast of \$100,000 and its update of \$428,000, and \$25,000 in 2006.

The Board directs AUI to use the Additional Audit Fee Deferral Account to capture the differences between actual expenditures and the approved new reporting requirements costs of \$264,000 in 2005 and \$25,000 in 2006. The Board directs AUI when it reconciles the Additional Audit Fee Deferral Account balance to provide a reconciliation of the forecasted and actual amounts for new reporting requirements costs and demonstrate to the Board's satisfaction that the actual costs incurred by AUI are reasonable. The Board expects AUI to separate additional audit fees and professional fees into separate cost categories within the Additional Audit Fee Deferral Account.

The Board is satisfied that all other professional fees forecast for 2005 and 2006 are reasonable. The Board therefore approves AUI's forecast of \$178,100 in 2005 and \$182,400 in 2006.

7.6 Regulatory Fees

AUI forecasted regulatory fees of \$959,074 in each of 2005 and 2006. AUI confirmed that it proposed to amortize the \$623,000 closing balance of deferred regulatory costs plus 2005 and 2006 additions over two years.⁶⁵

The CG considered that the deferred regulatory balance plus 2005-2008 additions should be amortized over 4 years to mitigate the rate increase caused by AUI's proposed two-year amortization. The CG estimated an amortization of \$457,000 per year was required to bring the balance to close to zero over 4 years. This would reduce annual regulatory fees by \$502,000 per year.

AUI submitted that the rationale for bringing the regulatory hearing cost deferral account to zero was to ensure that incurred costs were expensed in a timely manner in accordance with general accounting guidelines. Additionally, it provided a matching of expense and benefits so that the costs incurred for each test period were recovered during that test period. AUI also confirmed that it would likely file a 2007/2008 GRA and that it should not be any more costly than this GRA.⁶⁶ Further, AUI submitted that the Generic Cost of Capital formula was approved for a 5-year period⁶⁷ and therefore there should not be any cost of capital proceedings until 2009.

The Company submitted that at the time of the compliance filing, the regulatory deferral account be updated to reflect recent cost decisions by the Board. Income tax, return, and other secondary impacts should also be reflected in the compliance filing. With exception to the costs pertaining to the Generic Cost of Capital, there was no rationale for deferring costs beyond the 2005/2006 test period. Accordingly, the Company submitted that the CG's argument be rejected.

⁶⁵ Tr. p. 76

⁶⁶ Tr. p. 77

⁶⁷ Tr. p. 76

The Board agrees with AUI that bringing the regulatory hearing cost deferral account to a zero balance will ensure that incurred costs are expensed in a timely manner as per general accounting guidelines while also matching the expense and benefits so that the costs incurred for each test period are recovered during that test period. The Board considers deferring the costs beyond the 2005 and 2006 test period is unwarranted. The Board also considers that the per customer rate impact resulting from recovery of regulatory fees over the test years is acceptable. The Board therefore approves AUI's regulatory fees as filed.

7.7 Inflation Forecast

AUI submitted that given the economic climate at the time the application was filed and the climate that exists today, the inflation forecast of 2.1% is more reasonable and should be accepted.

The CG noted that AUI used an inflation rate for the test years that was higher than the expected rate. AUI agreed that the April 13, 2005 Alberta budget incorporated the Alberta Consumer Product Index (CPI) of 1.70% for 2005 and 1.90% for 2006 and 2007.⁶⁸ The CG submitted that these percentages were lower than the 2.1 % AUI had employed in the filing. Accordingly, the CG proposed that the lower inflation rates be applied resulting in the corresponding reduction to the forecast revenue requirement of \$10,467 in 2005 and \$5,999 in 2006.

The Board is satisfied that AUI's inflation forecast is within an acceptable range of the forecast Alberta CPI and considers a reduction to AUI's inflation forecast would have no significant impact on customers. The Board therefore approves AUI's inflation forecast as filed.

7.8 Capitalization of Administrative and General (A&G) Expenses

AUI proposed a reduction to the capitalization rate of 5% from 35% to 30% for 2006. This was a directional move which, if approved, would be followed by similar reductions in the following three years. The impact on the 2006 operating cost was an increase of approximately \$131,700. The Company believed that since approximately 50% of the capitalized amount related to salary, that salary distribution would be a good indicator of how much should be capitalized.

The CG did not agree that salary distribution was necessarily the correct driver for the other 50% of the A&G costs such as insurance, legal/audit/other fees and General Administrative expenses⁶⁹ that were not related to the amount of labour employed. The CG submitted that AUI should be directed to study this matter further and provide results at its next GRA. Until this study is completed, the CG recommended that there be no change in the percent of A&G capitalized for 2006. Accordingly, CG proposed the O&M costs for 2006 be decreased by \$272,925.

The Company suggested that the change to the capitalization rate would better reflect cost drivers and further, ensured that future customers were not inappropriately burdened by costs that should be borne by today's customers. The Company submitted it was prepared at the time of its next GRA to provide further analysis to substantiate further changes. Therefore, AUI suggested that the proposed capitalization rates for 2005 and 2006 be approved as filed.

⁶⁸ T2 p. 305 lines 7-8

⁶⁹ Response CG-AUI-61(b), page 4 and Response CG-AUI-129 (b)

The Board agrees with the CG that a change in the capitalization rate for A&G needs further study to ensure that the appropriate cost driver for this change is salary. This study should include an assessment of the practices of other utilities on capitalization of A&G and the determination of appropriate cost drivers for A&G costs other than employee benefits. Until AUI demonstrates through a detailed study that salary is the appropriate cost driver for capitalization rates, the Board considers that maintaining the status quo of 35% is appropriate. The Board directs AUI to maintain the capitalization rate at 35% for 2006 and reflect this change in its compliance filing.

7.9 Credits to Expenses re Services provided to Affiliates/Affiliate Transactions

AUI recorded the amount of revenues it received from certain affiliates as a credit to O&M expenses. These amounts were forecasted to be \$105,400 in 2005 and \$141,200 in 2006 and relate to an “allocation of shared services to affiliated companies for Information Technology, Customer Information system and Billing and Financial support services.”⁷⁰

With respect to the test years, the CG noted there was no forecast of revenues from the AOT Partnership as the service was expected to be terminated in 2004, but that had since been revised to be terminated by the end of 2005. Therefore, the CG recommended that the forecast for 2005 be increased by about \$49,000, being an estimate assuming the 2004 actual amount would be applicable for 2005 as well. The CG submitted that a deferral account be set up so that if these services were provided to the AOT Partnership in 2006, the actual revenues would be recorded and refunded to customers.

The Company did not object to the CG’s adjustment related to the AOT Partnership in 2005 but opposed a deferral account being set up with respect to the credit for the 2006 period. The Company stated that the agreement with the AOT Partnership would be terminated in 2005 and accordingly, there was no need for a deferral account.

The Board concurs with the CG and AUI that inter-affiliate contracts be increased by \$49,000 in 2005 because the contract with the AOT Partnership has not been terminated. The Board however sees no need for a deferral account to be created for 2006 given AUI’s assurance that this agreement would be terminated in 2005.

The Board directs AUI to include in its compliance filing an increase of \$49,000 in 2005 for inter-affiliate contracts.

7.10 Compliance with Code of Conduct

The services provided to the affiliated companies in 2005-06 were to companies that were considered to be “for profit” under AUI’s Code of Conduct.⁷¹ However, the CG submitted that AUI had no way of demonstrating that these services were in fact provided at Fair Market Value (FMV). The CG considered that the services provided to affiliates were capable of being valued in the market as the services were of the type that have been out-sourced by a number of companies. The use of a “cost plus” rate was not necessarily an indication that the rate approximates FMV. The CG submitted that AUI had not met the obligation under the requirements of Section 4.2.2 of the Code of Conduct. The CG therefore submitted that AUI be directed to file, at its next GRA, the following:

⁷⁰ Response CG-AUI-61(b)

⁷¹ CG-AUI-62(r)

1. evidence that FMV comparisons were not available; and
2. in the event that AUI was able to provide the evidence noted it should provide full details of all the cost components used to price the services provided to affiliates. (These costs should include direct and indirect labour, materials and supplies (including an appropriate share of the capital and operating costs of AUI's computer and billing systems) as well as all indirect expenses as well as general and administration expenses.)

AUI noted that the EUB's Utilities Branch Audit Group did not appear to agree with the interveners as its review of the Company's annual compliance audit did not identify any instances of non-compliance. AUI submitted that its Code of Conduct matters could be part of a GRA if the EUB found evidence of non-compliance. However, the Company submitted that a detailed review of compliance with the AUI Code of Conduct in the context of a GRA was not necessary and would be duplicative. Further under the Code of Conduct, the Company was permitted to share services on a cost recovery basis with affiliates. The Company may have shared a service on a cost plus basis with affiliates and utility affiliates, but AUI submitted that did not mean that the Company was in breach of the Code of Conduct. Ensuring that there was a recovery in excess of costs where no market value existed ensured that no harm would be borne by customers.

The Board is satisfied that AUI appears to be in compliance with its Code of Conduct and notes that AUI is required to file with the Board annual Compliance Reports detailing inter-affiliate transactions and instances where AUI failed to be in compliance. However, AUI must justify at its next GRA that costs related to affiliates comply with the Code of Conduct. The Board reiterates that the onus remains with the utility to justify its costs, with only one measure being its compliance with its Code of Conduct.

7.11 Short Term Incentive Plan (STIP)

AUI stated that:⁷²

Short term incentive compensation is available to all employees, except the President, and provides them with an opportunity to earn an annual incentive of 7% of base salary based on the achievement of specific annual goals in the following areas: financial targets (net income weighted at 30%, and operating expenses weighted at 25%); customer satisfaction targets weighted at 15%; individual goals weighted at 25%; safety goal weighted at 5%. This incentive structure has been a matter of negotiation with the Union that represents Company employees during collective bargaining, and is contained in the present Collective Agreement. Three senior managers are eligible to earn an additional 15% incentive based on a combination of company and corporate financial results, and the achievement of individual goals. The President is eligible to earn an annual incentive of 40% of base pay based upon a combination of Corporate financial results, Company financial results, and the achievement of individual goals. This current general rate application includes provisions in 2005 for incentive payments of \$742,400, and in 2006 for payments of \$768,384.

The CG submitted that 50% of the incentive payments related to operations should not be included in revenue requirement. Similarly, the CG felt that incentive payments related to capital

⁷² Refer to BR-AUI-18(g)

should also be reduced correspondingly. The CG further submitted that this would appear to be a very conservative treatment given shareholder goals could comprise from 55% to 60% of the total STIP goals. Further, those amounts not paid out also reverted to shareholders, in 2004 about \$180,000.

The CG submitted that NWC, as forecasted in the Application, was overstated by \$300,000 in 2005 and \$299,000 in 2006 because of the timing of STIP payments. AUI acknowledged that the timing of STIP payments, made in February following the end of the plan year, was not reflected in the NWC calculation.⁷³ During the hearing, AUI provided calculations of the reductions in NWC attributable to the timing of STIP payments.⁷⁴

The Company submitted that the full cost of the incentive plan benefited customers by attracting qualified people to the Company. The Company suggested that until the present time they had had great success in retaining employees⁷⁵ and that the STIP payments were an important part of the Company's strategy in that regard. The Company submitted that the STIP payments were reasonable and should be allowed in revenue requirement for the test years.

The Board agrees with the CG that STIP payments that are to the benefit of shareholders and not to the benefit of customers should be denied. In Decision 2003-061, regarding AltaLink's 2002/03/04 GRA, the Board only allowed 50% of STIP in the revenue requirement, the 50% essentially representing ongoing benefits to customers. The Board disallowed the entire long-term incentive plan (LTIP) because the results were solely to the benefit of shareholders.

While the Board recognizes that employees are a valued resource, especially for a small utility such as AUI, based on the above, 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%). In its compliance filing, the Board therefore directs AUI to exclude all amounts for STIP compensation for both the 2005 and 2006 test years that are based on financial targets and operating expenses (assumed to be 55%), and provide the supporting calculations used in the determination of the reduced forecast amounts for STIP compensation.

7.12 Charitable Donations and Sponsorships

The CG argued that charitable donations and sponsorships expenses should be denied based on past Board precedents and policy. The Company, however, submitted that this type of community support had historically been included in revenue requirement and was reasonable for the Company's business. As a commercial entity in the communities served, AUI suggested there was a general expectation that the Company support the community.

The Board notes in Decision 2004-067⁷⁶ respecting EPCOR Distribution, the Board stated:

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

⁷³ Tr. p. 66

⁷⁴ Exhibit 13-012

⁷⁵ Tr. p. 13

⁷⁶ Decision 2004-067, p. 50

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.

Although the donations and sponsorship amounts are small, the Board does not consider it appropriate for these costs to be borne by ratepayers. Further, the Board is not persuaded that AUI's perceived community expectation warrants inclusion of this expense in the revenue requirement.

The Board therefore denies any charitable donations and sponsorships included in AUI's revenue requirement and directs AUI to reflect these changes in its compliance filing.

7.13 Material, Contractor and Other

AUI forecasted increases of \$314,000 and \$353,000 in material, contractor and other charges as compared to 2004 allowed amounts.⁷⁷ In CG-AUI-62(q), AUI proposed to expense two items that the CG considered should be capitalized; anode replacements at \$136,000 in each test year and lowering of high pressure lines at \$150,000 in each test year.

The CG submitted that both of these expenditures allowed the high pressure pipelines to achieve their expected lives appear to qualify as capital expenditures under the capitalization policies of other utilities (ATCO Gas⁷⁸ and EPCOR⁷⁹). The CG suggested that the \$286,000 of expenses forecast by AUI for replacing sacrificial anodes and lowering high-pressure lines should be capitalized in each of 2005 and 2006. AUI considered that the CG was introducing new evidence, which was not properly presented before the Board. The Board agrees with AUI that the CG's reference to the capitalization policies of ATCO Gas and EPCOR constitutes new evidence and will not be considered by the Board.

The Company submitted that these items should be expensed because they did not have an ongoing incremental value in that neither the anode replacement nor the lowering of the high-pressure lines would significantly increase the expected life of the assets concerned.⁸⁰

AUI confirmed that both of these activities enabled the Company to achieve the projected life of the high-pressure lines and the steel risers.⁸¹ The Board accepts AUI's submission that replacing sacrificial anodes and lowering high-pressure lines do not significantly extend the life of an asset but helps achieve the projected life of an asset. The Board considers that expensing these costs is appropriate and approves the costs as filed.

The Board does however see merit in AUI filing its capitalization policy with the Board at its next GRA so that all parties benefit from a better understanding of AUI's capitalization policy. The Board directs AUI to file a detailed capitalization policy at its next GRA.

⁷⁷ Schedule 12.1

⁷⁸ ATCO Gas GRA, Response to CG-AG-6(b)

⁷⁹ Appendix C-1, 2005/2006 GTA, EPCOR Distribution Inc.

⁸⁰ Tr. p. 78 line 10, Mr. Heikkinen

⁸¹ Tr. p. 78 and 79

8 DEPRECIATION EXPENSE AND AMORTIZATION EXPENSE

AUI forecasted depreciation expense of \$9,080,762 and \$8,923,459 for the 2005 and 2006 test periods, respectively.⁸²

8.1 Account 473 – Services - Net Salvage

AUI recommended that net salvage for the Service account change from -30% to -65%. The recommended change was based on the experience of AUI's expert witness, Gannett Fleming Inc., and the rates used by peer companies and the expectations of AUI management.⁸³

Based on the comparison to the peer group utilized by AUI⁸⁴, a comparison to the American Gas Association net salvage for this account, and the apparent unreliable net salvage data for this account, the CG recommended that the existing net salvage used in the last depreciation study (i.e., -30%) be retained.

The Board considers that a net salvage of -65% for Account 473-Services is consistent with AUI's peer group and the expectation of AUI management, and reflects the high costs associated with removing pipe from residential neighbourhoods. The Board also notes in the previous depreciation study, similar considerations would have resulted in a net salvage percentage of approximately -65% as well. However, in the 2004 depreciation study, the rate was reduced to -30% to recognize the terms of the previous negotiated settlement agreement which resulted in a reduction to the net negative salvage expense.⁸⁵ The Board therefore approves the net salvage for Account 473-Services as filed. The Board therefore approves the net salvage for Account 473-Services as filed.

8.2 Account 478 – Meters - Net Salvage

AUI argued that the net salvage for the Meters account be changed from +10% to 0%.⁸⁶ AUI submitted that it followed a cradle-to-grave accounting treatment for meters and therefore would not expect any reuse salvage.

The CG submitted that a 5% net salvage for meters should be adopted in this proceeding based on consideration of AUI's peer group, the fact that there were gross salvage proceeds associated with meters sold as junk with some gross salvage, and the actual historical net salvage experience which averaged 4% over the period 2001 to 2004.

The Board accepts the CG's 5% net salvage recommendation for meters. The Board notes that the CG's recommendation also represents the midpoint from the current 10% to 0% advocated by AUI. The Board therefore directs AUI to include in its compliance filing a net salvage of 5% for Account 478-Meters.

⁸² BR-AUI-5(IR2) – Attachment – Revised Schedule 6.1

⁸³ CG-AUI-69(c)

⁸⁴ CG-AUI-136, AUI provided AUI's peer group utility reference for this account: Centra Gas Manitoba (-15%), Centra Gas BC (-25%) and ATCO Gas (-100%).

⁸⁵ Page III-5/6 of Exhibit 02-008-019, Footnote 1

⁸⁶ Refer to response to IR CG-AUI-69(c), pp. 5 and 6

8.3 Accounts 483.1 and 486 – Furniture and Equipment and Tools and Work Equipment - Amortization Period

AUI submitted that the quality of materials used in the manufacture of office furniture had diminished, which resulted in an increased depreciation factor as the equipment would wear more quickly. Similarly, tools and work equipment had also experienced similar changes in manufacturing standards, resulting in shorter lives. AUI also submitted that newer digital versions of equipment did not last as long as older mechanical types and were also susceptible to technological obsolescence. AUI thus considered that, given its current inventory of these assets, a reduction in useful life to 15 years was warranted.

For purposes of making a comparison with AUI's policy, the CG submitted that ATCO Gas had used, and was continuing to use, a 20-year amortization period for office furniture and tools and work equipment. The CG submitted that AUI's evidence was anecdotal and unsupported and should not be used as a substitute for that of a relevant peer company. The CG argued that the 20 year amortization period should be retained for these assets.

The Board considers that AUI has not demonstrated to the Board's satisfaction that the useful period of furniture and equipment and tools and work equipment has declined. The Board therefore directs AUI to include in its compliance filing an amortization period of 20 years for accounts 483.1 and 486. Should AUI wish to pursue this issue in a future GRA, the Board would expect AUI to provide sufficient evidence to demonstrate that a change in the amortization periods for this type of equipment is warranted.

8.4 5 Year Minimum Amortization Period

AUI recommended that the shortest average service life of any asset within the system should be used, consistent with Board's findings in the AltaLink and FortisAlberta decisions.

The CG submitted that a minimum 5-year amortization period for depreciation reserve true-up was consistent with that used for ATCO Gas. The CG submitted that the Board should direct AUI to adopt this approach for the purposes of its compliance filing.

With respect to the amortization period for accumulated depreciation account variances, the Board concurs with AUI that the shortest average service life of any asset within the system should be used, consistent with the most recent AltaLink⁸⁷ case. The Board therefore approves AUI's amortization period of 3-years, reflecting shortest average service life of any asset within the system.

8.5 Use of 2005 and 2006 Plant Balances to Determine Depreciation Rates

AUI argued that it was preferable to use the forecast mid-year balances of plant for the test years, as opposed to 2003 actual data to derive the depreciation rates. Although inclusion of forecast information was conceptually advantageous, it was often not practical, as the forecast information was not aged by vintage at the time the forecasts were prepared. However, in AUI's circumstances, the historic aged vintage surviving balances were determined through the use of the computed mortality method. As such, very little additional effort was required to include the

⁸⁷ Decision 2005-019, AltaLink 2005-2007, p. 99

forecast information into the calculations of computed mortality, and gain the advantage of a more proper matching of the aged surviving balances to the plant being depreciated.⁸⁸

The CG recommended that AUI revert to the traditional method used by utility companies regulated by the EUB of basing their depreciation rates, determined through a depreciation study, on the last historical data year available at the time of the preparation of the depreciation study. The CG submitted that AUI should re-calculate its depreciation rates in the compliance filing to conform to this recommendation.

The Board agrees with the CG that the traditional method used by utility companies in Alberta is to base their depreciation rates on the last historical data year available at the time of the preparation of the depreciation study, but considers the inclusion of forecast data does not materially impact depreciation rates. The Board also considers that information that may enhance matching of aged balances to the plant being depreciated may be advantageous. The Board is prepared to accept AUI's methodology that includes forecast balances in its depreciation study for the 2005 and 2006 test years, but directs AUI to justify any future use of forecasts within its depreciation study at its next GRA.

8.6 Annual Updates of Depreciation Rates

AUI was satisfied with updating depreciation rates at the time GRAs were filed. The CG supported the recommendation that while there was historical precedent for annual updates of depreciation rates, this approach had only been used for electric utilities and would not be beneficial or cost effective in the case of AUI.⁸⁹ The Board concurs that updating depreciation rates at the time of AUI's GRAs are filed is sufficient.

8.7 Simplification of Depreciation Rate Determination

The Company did not oppose the concept of simplification of depreciation rates, but submitted that it did not have the expertise to accurately determine the rates at this time. The Company was also in favour of reducing hearing costs. However, the Company submitted that using the advice of depreciation experts was of considerable value and was likely less costly than the Company obtaining the relevant depreciation expertise in-house.

The CG submitted that any further Board, intervener or Company-related initiatives associated with reducing costs related to depreciation accounting and regulatory proceeding, which do not significantly compromise regulatory and depreciation principles or unnecessarily affect the rights of any party, are a welcome change that should be embraced by all parties.

Although the Board has expressed some concerns about the efficiency and added value associated with detailed depreciation studies and frequency of filing such a report, the Board considers that further discussion and assessment will be required before a determination may be reached on this issue. At this time, the Board is satisfied that evidence of depreciation experts assist the Board in making its determinations on depreciation matters. The Board directs AUI to justify its depreciation rates at its next GRA.

⁸⁸ CG-AUI-70a

⁸⁹ BR-CG-4(a), (b)

9 INCOME TAXES AND LARGE CORPORATIONS TAX

AUI determined its income taxes for 2005 and 2006 using the flow-through method. Under this method AUI claims all available deductions that it would be entitled to under federal and provincial legislation to compute taxable income. Accordingly, differences between the tax basis of an asset or liability and its carrying value in AUI's balance sheet, which would give rise to recognition of future income tax assets and future income tax liabilities,⁹⁰ were not taken into account. For 2005 and 2006, AUI forecast amounts of \$264,100 and \$59,800, respectively, for income taxes and large corporations tax (LCT).

9.1 Non-deductible meals

The CG noted that in determining its income tax expense, AUI included amounts of \$50,000 as a non-deductible amount for meals expenses in each of 2005 and 2006 but that AUI subsequently stated that the amounts were \$37,700 and \$38,400, respectively.⁹¹ AUI agreed that the amounts were overstated by \$12,300 and \$11,600, respectively, and that revenue requirement should thus be reduced by approximately \$6,000 in each year.⁹²

The Board concurs with the reductions in revenue requirement of approximately \$6,000 in each of 2005 and 2006 due to the overstatement of non-deductible amounts for meal expenses and directs AUI to make the appropriate adjustments in its compliance filing.

9.2 LCT

LCT is a tax on capital and is not deductible for income tax purposes. In calculating LCT a corporation may deduct an amount of \$50 million as a capital deduction unless it is related to another corporation at any time in its taxation year, in which case the deduction must be allocated among all related corporations in such amounts agreed by members of the related group. AUI is presently related to other corporations ultimately controlled by AltaGas Income Trust. For 2005 and 2006, AUI calculated LCT to be \$185,100 and \$133,000, respectively, without deducting any amount for the capital deduction.

The CG argued that AUI should be eligible to claim a portion of the capital deduction. The CG noted that AUI had provided information indicating a proportional forecast allocation of 13.055% of the capital deduction amount could reduce LCT by \$11,443 and \$8,159 in 2005 and 2006, respectively.⁹³ Accordingly, the CG argued that the capital deductions for 2005 and 2006, as grossed-up for income tax in amounts of \$17,206 and \$12,290, respectively should be adjusted in revenue requirement. AUI agreed that its LCT in 2005 and 2006 could be reduced by an allocation of the capital tax deduction as it had forecast.

The Board concurs that AUI should deduct a portion of the \$50 million capital deduction in calculating its LCT and adjust its revenue requirement accordingly. The Board considers that the capital deduction amounts should represent the percentage that AUI's aggregate taxable capital is of the total taxable capital of all corporations that it would be related to in 2005 and 2006, as would be determined in accordance with the provisions of the *Income Tax Act*, Chapter 1 (5th

⁹⁰ Refer to Section 3465 of the Canadian Institute of Chartered Accountants Handbook

⁹¹ Refer to AUI response to IR CG-AUI-77(c)(ii)

⁹² Refer to AUI response to IR CG-AUI-140(b)

⁹³ Refer to Exhibit 13-041

Supp.), R.S.C. 1985, as amended. Accordingly, the Board directs AUI to make the appropriate adjustments in its compliance filing.

9.3 Engineering and Supervision (E&S) Costs

AUI stated that it performs virtually all of its engineering and supervision functions with its own staff and capitalized 35% of employee benefits (proposed to be 30% for 2006) and 35% of certain administrative costs (proposed to be 30% for 2006). The amounts for the test years were \$1,745,835 and \$1,725,919, respectively.

The CG argued that the E&S costs capitalized should be deducted in the year incurred in calculating taxable income. The CG submitted that AUI's costs were similar to costs capitalized and deducted in the year incurred for income tax purposes by ATCO Electric Ltd. Therefore, the CG proposed that AUI undertake an immediate comprehensive review of this matter and reduce its revenue requirement in its compliance filing for this proceeding should the costs qualify as being deductible for income tax purposes in the year incurred.

AUI disagreed with the CG's position. AUI stated that its practice was consistent with an Industry Settlement that AUI was a part of in 1995, and with Canada Revenue Agency's subsequent agreement on the change in treatment of overhead capitalized. AUI considered that the add-backs it makes for tax are consistent with the law and therefore for it to take a different interpretation now, just because another company may, would be an unacceptable risk. Further, AUI submitted that no benefit would accrue to customers in taking on this additional risk.

The Board notes that use of the flow-through method for determining income taxes involves claiming such available deductions in a year as may be allowed under governing legislation. The Board also notes that AUI has been consistently following a method it considered to be correct in respect of its E&S costs capitalized and that the issue involves a matter of timing in that under AUI's practice the costs involved would be deducted over a longer period as capital cost allowances. Further, the matter of a cost being, for tax purposes, of a capital nature or expense can be subject to interpretation and therefore cannot necessarily be applied to AUI on the basis of that used by another utility.

Consequently, given the time required to conduct a proper review and the amounts involved, the Board will not compel AUI to adjust its revenue requirement for the test years. However, should AUI propose to continue using the flow-through method to determine its income tax amounts for regulatory purposes, the Board directs AUI to consult with its income tax advisor to ascertain whether the E&S costs it has capitalized for income tax purposes would otherwise qualify as being deductible in the year incurred and provide the Board with the advisor's written opinion on the subject no later than the time of its next GRA.

9.4 March 2005 Federal Budget Changes

In response to CG-AUI-79(b), AUI stated it did not incorporate the proposed CCA rate changes announced in the March 2005 federal budget since these rates were not substantially enacted at the time AUI filed the Application. The CG therefore recommended that AUI be directed to set up a deferral account such that if and when the proposed changes are enacted, AUI would recalculate the income tax expense included in its 2005-06 revenue requirement and set up a refund for future distribution. In response to CG-AUI-79(b), the Company agreed to implement these changes if and when they materialize.

The Board concurs with AUI that a deferral account is unnecessary, and directs AUI to reflect any changes in CCA rates in its compliance filing.

10 COST OF CAPITAL

10.1 Return on Common Equity

In its Application, AUI used a return on common equity rate of 9.50% for 2005 and 9.60% for 2006.⁹⁴ The CG submitted it is premature to forecast the return on common equity (ROCE) for 2006 given the Board's Decision U2004-423 which only set the ROCE for 2005 at 9.50%. Given that the Board will reset this rate in the fall of this year for 2006, the CG submits that the Board direct that the 9.50% be used as a placeholder at this time. The Company has stated in BR-AUI-21(b) that there is no particular advantage to using 9.5% or 9.6% as a placeholder. Accordingly, the Company is indifferent to which figure is used as the placeholder.

The Board therefore directs AUI to revise its common equity placeholder for 2006 to accord with the recent Board Order U2005-410 (2006 Generic Return on Equity Formula Result) and to reflect the revised number in its compliance filing.

10.2 Cost of Debt

In late 2004, \$30 million in new debt was placed and was deemed to be in place pursuant to the 2003/2004 MOA since the beginning of 2003. This debt is referenced as 2003 New Debt on Schedule 16.3.⁹⁵ In October of 2005, the original 2000 Debt in the amount of \$30 million will expire and the Company expects to have issued through its parent a new \$30 million dollar issuance to replace this expiring 2000 debenture. Accordingly, in the test year 2005, \$60 million in long-term debt will be in place. In 2005, the \$60 million in long-term debt consists of the \$30 million 2000 Debt at a cost rate of 7.42% until October 2005, to be replaced by the \$30 million 2005 New Debt at a forecast cost of 6.95%. As well, during 2005 the \$30 million 2003 New Debt issued in late 2004 at a cost rate of 6% will be in place for the entire year. In 2006, the \$60 million in long-term debt will consist of the 2005 New Debt issued in October 2005 and the 2003 New Debt.

For 2003 New Debt, AUI acknowledged that the Application overstated the debt rate at 6.09% and that AUI will correct this rate to 6.00% in a compliance filing.⁹⁶ The CG agreed and submitted that AUI should correct Schedule 16.3 in a refiling to incorporate the amended rate of 6.00% for 2003 New Debt.

The Board concurs with this revision and directs AUI to reflect a rate of 6.00% for 2003 New Debt in its compliance filing.

AUI proposed that the \$30 million principal amount of 2000 Debt be refinanced in 2005 at a rate of 6.95%. The AUI proposed rate of 6.95% is derived as 4.8% for a forecast 5 year Government of Canada bond, 0.15% for issue costs, and 2.00% for credit costs.⁹⁷

⁹⁴ Application X-02-001, Schedule 16.1

⁹⁵ Exhibit 02-004-00 Schedule 16.3

⁹⁶ CG-AUI- 84 and CG-87(b) and Tr. Vol 3, p. 358

⁹⁷ CG-AUI-87(a)

Historically, AUI has obtained financing from its parent corporation through short term instruments and provided longer term financing to AUI at deemed rates.⁹⁸ If no replacement debt is issued in 2005 the CG argued that then a short-term borrowing rate should be used in the calculation of the debt portion of the cost of capital.

In terms of the deemed long-term 5 year debt, the CG submitted that the base interest rate for 5 year Canada bonds at 4.8% does not comport with the present day reality of the interest rate environment. For instance, the Globe and Mail indicates that the 5 year Government of Canada benchmark as at August 6th is 3.48% as contrasted to the rate in the AUI Application of 4.8% (a difference of 1.32%).

The CG argued that AUI failed to justify the 2.00% credit risk premium over 5 Year Government of Canada bonds beyond a simple reference to a Scotia letter. AUI indicated that the recent Utility Debt Issues, shown in BR-AUI-3(c), had a lower range of A low but in fact the Fortis BC issue had a rating of triple B high. This rating is close to the triple B low rating of AIT and the Fortis BC spread over the 5 year Canada bond was shown as 101 basis points. The CG submitted that a 100 basis point spread over a 5 year Canada bond would be more reflective of the cost of financing for a comparable utility and submits that a 100 basis points spread should be used for the calculation of a placeholder rate for the AUI proposed replacement financing.

The CG recommended that AUI provide a 5 year debt cost placeholder in a refiling that reflects the sum of the following:

- a 5 year Canada bond benchmark that is calculated as an average of the past 3 months as provided in the financial section of the Globe and Mail; and
- a 100 basis point spread for credit risk; and
- 15 basis points for issue costs as proposed by AUI.

The Company stated that it intends to file its application for the 2005 New Debt at the beginning of September, and therefore the imposition of a short-term borrowing rate. AUI indicated that it expected that the long-term debt cost will be deemed, as has been the traditional Board practice.

AUI argued that rate quotes from the Globe and Mail and other sources cited by the CG constitutes new evidence and therefore should be disregarded entirely.

AUI proposed that the \$30 million principal amount of 2000 Debt be refinanced in 2005 at a rate of 6.95%. The proposed rate of 6.95% is derived as 4.8% for a forecast 5 year Government of Canada bond, 0.15% for issue costs, and 2.00% for credit costs. The Board recognizes that a placeholder is required as until such time as the Board issues a decision on AUI's debenture application and related cost of debt. The Board is satisfied by AUI's assurances that a debenture application will be filed in the fall, and thus establishing short term debt until the Board's decision on AUI's debenture application is unwarranted. With regards to the appropriate placeholder, the Board considers that the CG's recommended use of the a 5 year Canada bond benchmark that is calculated as an average of the past 3 months as provided in the financial section of the Globe and Mail constitutes new evidence and therefore is given no weight by the Board. The Board accepts AUI's use of a forecast 5 year Government of Canada bond at 4.8%

⁹⁸ Tr. Vol 2, p. 231 and Tr. Vol. 3, p. 332

and issuance costs of 0.15% as reasonable. However, the Board considers a credit risk premium in the lower end of the range of the forecast 175 – 200 basis points spread above the Government of Canada 5-year rate, especially given the premiums of comparator group of utilities referenced by AUI in response to BR-AUI-3(c).

Therefore, the Board approves a deemed debenture placeholder amount of 6.7% for the \$30 million principal amount for 2000 Debt that is to be refinanced in 2005. The Board directs AUI to reflect this revision in its compliance filing, and the 6% for the 2003 New Debt of \$30,000,000. Upon approval of AUI's debenture application, the Board directs AUI to reflect this change in its revenue requirement and apply any change in the cost of debt at its next GRA.

11 OTHER

11.1 Customer Deposits

The CG submitted that, as per Section 7.8 of the Natural Gas Service Rules, while AUI pays interest on these deposits at 2% per annum, it has the use of these customer-provided funds that are used to fund its operations on a day to day basis. Generally, such funds should be included in the computation of necessary working capital as a reduction. Accordingly, the CG recommended that the full amount of the average deposits held by AUI be included in the NWC for 2005 and 2006. According to CG-AUI-147(b), this amount is \$1.63 million in 2005 and \$1.66 million in 2006. To recognize the cost AUI has to pay on these customer deposits, the CG recommends that the Board direct AUI to provide a computation of these costs for the test years and such costs should be included as a cost recovery. This will ensure AUI is kept whole and the customers are properly compensated for the funds advanced to AUI.

The Company pays interest on customer deposits it holds. By paying a rate of interest commensurate to an interest-bearing bank account suggests that customers are already fairly compensated. The Board agrees with AUI that customer deposits are highly susceptible to variability as deposits are refundable on demand. Customer deposits can be drawn down either to pay overdue account balances, reimburse customers that attain a good payment history, or who leave the system. The Board considers that including deposits as working capital is unwarranted and therefore the CG's recommendation is hereby denied. As per Section 7.8 of the Natural Gas Service Rules, AUI should continue to pay interest on these deposits at 2% per annum.

11.2 Unearned Revenue

In Section 17 of the Application, AUI showed \$22,500 of unearned revenue in the 2003 financial statements. In CG-AUI-97(e)(iv), AUI stated that the \$22,500 unearned revenue related to a gain on sales of the Southeast District Office and in CG-AUI-47(d) stated that this unearned revenue item related to gain on sale of plant was inadvertently missed and should be brought into income in the 2005 test period. The CG accordingly recommended that AUI, in its 2005-06 Phase I Compliance Filing include this amount of \$22,500 as other revenues for 2005. AUI suggested in CG-AUI-97(e)(iv) and CG-AUI-147(d) that the gain on sale of plant of \$22,500 should be brought into income for 2005. The Board agrees with the CG and AUI that the gain on sales of the Southeast District Office of \$22,500 should be reflected as other revenue and included as income for 2005.

The Board therefore directs AUI to reflect the gain on sales of the Southeast District Office of \$22,500 as income in 2005.

11.3 AUI Corporate Reorganization

At the time of the hearing, AltaGas Utility Holdings Inc. had filed an application with the Board for approval of a share transfer, which would ultimately result in the spinoff of AUI into a subsidiary of a new company, which is to be a publicly traded company.

The CG considered that this proceeding, rather than the share transfer proceeding, was the better place to deal with any matters that may impact on the 2005 or 2006, revenue requirements, as a result of the share transfer application by AltaGas Utility Holdings Inc. AUI stated that it does not forecast a change in costs as a result of the spin-off and submits that a separate proceeding would simply create unnecessary costs and complexity.

The CG was primarily concerned with potential changes in affiliate transactions. Although AUI claimed that it will require all of these shared services in the future after the restructuring and that there is no reason to believe that the costs would be different,⁹⁹ the CG considered that the most effective manner to address the possible change in shared costs is to approve a placeholder for shared services for 2005 and 2006 and review any changes in costs when they are known with greater certainty, by way of a separate proceeding.

In Decision 2005-112, dated October 14, 2005, dealing with the share transfer application, the Board assured customers that AUI's corporate reorganization and related share transfer shall be subject to the Board's "no harm" principle. Specifically, the Board approved the transfer of 100% of the outstanding shares in the capital stock of Holdings Inc. from the AltaGas Holding LP to Newco, subject to AUI addressing in AUI's next GRA and debenture application any changes in AUI's costs, 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, provided that the matters to be explored in the debenture application shall be limited to financial matters.

The Board therefore considers a placeholder for shared services for 2005 and 2006 to be unnecessary.

11.4 Sufficiency of the Record/Minimum Filing Requirements

In its Argument, the CG stated that the materials produced by the Company were, in places, "confusing and not easily understood", and that the, "volume of information provided should not be treated as a measure of its content or value to this proceeding." The Company submitted that the Application, two rounds of Information Requests scheduled by the Board, and other Board processes, provided a more than adequate forum to understand and test the issues, and that the record was sufficient and complete. AUI submitted that the Company has met the required onus to establish its rate base and revenue requirement.

With respect to minimum filing requirements, the Company indicated it supports any change to the regulatory process that the Board considers helpful. However, to meet minimum filing requirements, the Company stated it may require additional staff and further capital expenditures

⁹⁹ Tr. p. 86

and requests this be taken into account. It may be that a Board initiated Technical Meeting to explain the application and allow interveners an opportunity to provide comment on the filing is a preferable method of dealing with concerns with filed material.

The Board appreciates that AUI is a relatively small utility, but consider that the Company's size should not limit its onus to justify its revenue requirement and rate base, or the Board's and interveners' right to thoroughly examine the Application. The Board concurs with the CG that the dearth of information contained in the Application likely resulted in a protracted interrogatory process. Further, the Board considers that there may have been unnecessary costs incurred by parties that should not be applied to customers but instead to AUI. The Board will consider this issue in its Cost Order.

In the future, the Board expects AUI to file a more detailed GRA that provides qualitative and quantitative justification of its costs, and where appropriate, a business case justifying expenditures. The Board is supportive of the use of technical meetings or information workshops that might lead to a more efficient and effective regulatory process.

11.5 Compliance Filing

The Board directs AUI to revise its 2005-2006 GRA Phase I to reflect the Board's findings, conclusions and directions in this Decision and to re-file the amended GRA by December 16, 2005. The Board expects AUI in its re-filing 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 re-filing should file make a submission with the Board by January 5, 2006.

12 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 2005/2006 GRA Phase I (the Compliance Filing) as required by this Decision, on or before December 16, 2005 incorporating the findings and directions in this Decision.

Dated in Calgary, Alberta on November 29, 2005.

ALBERTA ENERGY AND UTILITIES BOARD

(original signed by)

R. G. Lock, P.Eng.
Presiding Member

(original signed by)

G. J. Miller
Member

(original signed by)

M. L. Asgar-Deen, P.Eng.
Acting Member

APPENDIX 1 – HEARING PARTICIPANTS

Name of Organization (Abbreviation) Counsel or Representative	Witnesses
AltaGas Utilities Inc. (AUI or AltaGas) F. Martin R. Jeerakathil	L. Heikkinen A. Mantei E. Tuele R. Koizumi L. Kennedy
The Consumers Group (CG), consisting of: Alberta Irrigation Projects Association (AIPA) H. Unryn Alberta Urban Municipalities Association (AUMA) J. Bryan, Q.C. Consumers Coalition of Alberta (CCA) J. Wachowich Municipal Gas and Co-op Interveners (MGCI) T. Marriott Utilities Consumer Advocate (UCA)	B. Shymanski
Direct Energy Partnership (DEP) K. Miller	
Alberta Energy and Utilities Board Board Staff R. Marx (Board Counsel) M. McJannet D. R. Weir, C.A. A. Laroia	

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. Therefore, the Board directs AUI in its compliance filing to: 5
 - re-examine the use of the consumption level of 138 GJ per customer in its NPV analysis and adjust the consumption level if appropriate, and if the result remains at 138 GJ, then AUI must provide additional information which will assist the Board in understanding that result;..... 5
 - quantify and explain all concerns and deficiencies contained in AUI’s Due Diligence Report;..... 5
 - re-examine why AUI did not forecast any replacement or increase in maintenance costs over the term of the NPV analysis and adjust for any conclusions reached which differ from the filed NPV analysis, and if the result remains unchanged, then AUI must provide additional information which will assist the Board in understanding that result; and..... 5
 - provide further explanation regarding the assumptions in the NPV and file an excel spreadsheet (including formulas)of the NPV analysis and any other calculations that would enable the Board to verify all of the numbers in the NPV analysis..... 5
2. The Board therefore directs AUI to reflect the revised forecast expenditures of \$40,480 for meter replacements for both test years in its compliance filing..... 6
3. AUI forecasted regulator replacement expenditures in both test years of \$99,000 in each of 2005 and 2006. During the hearing, AUI also reviewed its forecast of regulator replacements of \$99,000 in each of 2005 and 2006. The CG noted that AUI had revised those forecasts down to \$16,500 in each of those years, a reduction of \$82,500 in each year because AUI included some regulator replacements for new business in system betterment. The Board concurs with these revisions as they more appropriately reflect system betterment expenditures forecast for regulator replacements for the 2005 and 2006 test years..... 6
4. The Board therefore directs AUI to reflect the revised regulator replacements forecast expenditures of \$16,500 for both test years in its compliance filing..... 6
5. The Board therefore directs AUI to revise its forecast for the Superior System replacement in its compliance filing to reflect 50% of AUI’s forecast expenditures for the 2005 and 2006 test years..... 7
6. The Board therefore directs AUI to include its original 2005 forecast of relocation project expenditures of \$426,400 in its compliance filing..... 9
7. The Board agrees that there was some confusion regarding the capitalization of overheads and notes AUI’s willingness to provide additional information on the matter in its next GRA The Board therefore directs AUI at its next GRA to provide complete details of forecast overhead costs capitalized (including the basis on which they were determined) in order to facilitate the review and testing of its capital expenditure budgets..... 9
8. The Board concurs with AUI’s reduction of \$176,000 for the Southeast Reinforcement project. The Board considers that a reduction in AUI’s remaining forecast expenditures for transmission plant pipeline appears to be warranted for the 2005 and 2006 test years,

- based on AUI's history of over-forecasting these expenditures. The Board therefore directs AUI to exclude the \$176,000 for the Southeast Reinforcement project and reduce its 2005 and 2006 forecasts for the remaining transmission plant pipeline expenditures by 25% in its compliance filing. 10
9. The Board also notes that AUI has negotiated its last two Phase I GRAs in full or in part. Therefore, the Board did not previously require AUI to justify specific costs due to the understanding that any settlement was based on an agreement between the parties. The Board considers that detailed business cases to justify its business expenditures of over \$50,000 would be of assistance and directs AUI to file detailed business cases with its next GRA. 12
10. As a result of AUI failing to justify its proposed capital expenditures to structures and improvements, the Board considers a reduction of 15% on AUI's costs is warranted. Therefore, the Board directs AUI to include a 15% reduction to its forecast structures and improvements expenditures for both test years in its compliance filing. 13
11. For purposes of determining NWC, the use of a mid-year balance is appropriate. AUI stated that O&M inventory was based on the 2003 actual ending balance being maintained through 2005 and 2006. The Board accepts this premise. Using those balances for 2005 and 2006 and the actual closing balance of \$170,185 for 2004, the Board considers that the mid-year O&M inventory balance for the test years would amount to approximately \$185,000 and \$200,000, respectively. The Board thus directs AUI to adjust its 2005 amount for O&M inventory accordingly for purposes of its compliance filing. 13
12. In its deferred regulatory costs for 2005, AUI included an amount of \$20,000 for its 2003/2004 GRA Compliance Filing, Phase I. The CG noted that in Utility Cost Order 2005-011, dated February 17, 2005, the amount approved by the Board was \$4,069.49. AUI agreed that the amount in the cost order was correct. Accordingly, the Board directs AUI to make the appropriate adjustment in its compliance filing. 14
13. The Board therefore approves AUI's forecast consumption per customer for rural, residential and irrigation customers, but directs AUI to increase per customer usage for commercial customers to 630 GJ, and reflect this direction in its compliance filing including a breakdown of revenue forecast by rate class compared against a similar breakdown from AUI's original filing. 15
14. The Board concurs with the Company's revisions of the penalty revenues forecast and directs AUI to reduce its 2005 forecast of penalty revenues by \$14,521 and increase its 2006 forecast by \$22,124 in its compliance filing. 16
15. The Board notes, and accepts, AUI's intention to charge retail suppliers with the appropriate portion of transportation costs associated with their supply. In this regard, the Board directs AUI to provide sufficient details of transportation costs in its monthly GCRR filings, beginning January 2006, that would allow the appropriateness of actual transportation costs included in the GCRR to be determined. 18
16. The Board concurs with the \$50,000 reduction in 2005 resulting from the absence of maintenance contracts due to the deferral of the implementation of the work management system from 2004 to 2005. Further, the Board directs AUI to reduce its forecast of maintenance contracts for both test years by an additional 10% based on its record of over-forecasting. The Board directs AUI to file these revisions in its compliance filing. 21

17. The Board is of the view that AUI has failed to justify an increase in bad debt expense beyond referencing 2003 actual as a base year for the 2005 and 2006 forecasts. The Board concurs with the CG that AUI should use the average bad debt to sales ratio experienced in the period 2001-2004 of 0.23% to determine the appropriate expense for the test years. Thus the Board directs AUI to reduce its bad debts expense by \$33,562 in 2005 and \$43,660 in 2006, and file this reduction in its compliance filing..... 22
18. The Board concurs with the CG that AUI's forecasts were over-stated for both 2003 and 2004. Based on the stabilization of insurance premiums, the Board considers that a 5% reduction to insurance is warranted despite the minimal impact to customers. The Board therefore directs AUI to reduce its 2005 and 2006 insurance expense by 5% in its compliance filing. 22
19. The Board concurs with AUI that an increase in audit costs is warranted in order for AUI to comply with the demands for the new reporting requirements. However, the Board notes that forecast expenditures associated with increased audit fees for the new reporting requirements are subject to a significant degree of uncertainty. The Board therefore directs AUI to establish a deferral account (Additional Audit Fee Deferral Account) to capture the differences between forecast and actual amounts incurred in 2006 for the additional audit fees associated with the new financial reporting requirements. The Board further directs AUI, at its next GRA, to provide a reconciliation of the Additional Audit Fee Deferral Account balance and demonstrate that the actual costs incurred by AUI related to increased audit fees were reasonable. 23
20. The Board directs AUI to use the Additional Audit Fee Deferral Account to capture the differences between actual expenditures and the approved new reporting requirements costs of \$264,000 in 2005 and \$25,000 in 2006. The Board directs AUI when it reconciles the Additional Audit Fee Deferral Account balance to provide a reconciliation of the forecasted and actual amounts for new reporting requirements costs and demonstrate to the Board's satisfaction that the actual costs incurred by AUI are reasonable. The Board expects AUI to separate additional audit fees and professional fees into separate cost categories within the Additional Audit Fee Deferral Account..... 24
21. The Board agrees with the CG that a change in the capitalization rate for A&G needs further study to ensure that the appropriate cost driver for this change is salary. This study should include an assessment of the practices of other utilities on capitalization of A&G and the determination of appropriate cost drivers for A&G costs other than employee benefits. Until AUI demonstrates through a detailed study that salary is the appropriate cost driver for capitalization rates, the Board considers that maintaining the status quo of 35% is appropriate. The Board directs AUI to maintain the capitalization rate at 35% for 2006 and reflect this change in its compliance filing. 26
22. The Board directs AUI to include in its compliance filing an increase of \$49,000 in 2005 for inter-affiliate contracts. 26
23. While the Board recognizes that employees are a valued resource, especially for a small utility such as AUI, based on the above, 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%). In its compliance filing, the Board therefore directs AUI to exclude all amounts for STIP compensation for both the 2005 and 2006 test years that are based on financial targets and operating expenses (assumed to be 55%), and provide the supporting calculations used in the determination of the reduced forecast amounts for STIP compensation. 28

24. The Board therefore denies any charitable donations and sponsorships included in AUI's revenue requirement and directs AUI to reflect these changes in its compliance filing... 29
25. The Board does however see merit in AUI filing its capitalization policy with the Board at its next GRA so that all parties benefit from a better understanding of AUI's capitalization policy. The Board directs AUI to file a detailed capitalization policy at its next GRA. 29
26. The Board accepts the CG's 5% net salvage recommendation for meters. The Board notes that the CG's recommendation also represents the midpoint from the current 10% to 0% advocated by AUI. The Board therefore directs AUI to include in its compliance filing a net salvage of 5% for Account 478-Meters. 30
27. The Board considers that AUI has not demonstrated to the Board's satisfaction that the useful period of furniture and equipment and tools and work equipment has declined. The Board therefore directs AUI to include in its compliance filing an amortization period of 20 years for accounts 483.1 and 486. Should AUI wish to pursue this issue in a future GRA, the Board would expect AUI to provide sufficient evidence to demonstrate that a change in the amortization periods for this type of equipment is warranted. 31
28. The Board agrees with the CG that the traditional method used by utility companies in Alberta is to base their depreciation rates on the last historical data year available at the time of the preparation of the depreciation study, but considers the inclusion of forecast data does not materially impact depreciation rates. The Board also considers that information that may enhance matching of aged balances to the plant being depreciated may be advantageous. The Board is prepared to accept AUI's methodology that includes forecast balances in its depreciation study for the 2005 and 2006 test years, but directs AUI to justify any future use of forecasts within its depreciation study at its next GRA. 32
29. The Board concurs with the reductions in revenue requirement of approximately \$6,000 in each of 2005 and 2006 due to the overstatement of non-deductible amounts for meal expenses and directs AUI to make the appropriate adjustments in its compliance filing. 33
30. The Board concurs that AUI should deduct a portion of the \$50 million capital deduction in calculating its LCT and adjust its revenue requirement accordingly. The Board considers that the capital deduction amounts should represent the percentage that AUI's aggregate taxable capital is of the total taxable capital of all corporations that it would be related to in 2005 and 2006, as would be determined in accordance with the provisions of the *Income Tax Act*, Chapter 1 (5th Supp.), R.S.C. 1985, as amended. Accordingly, the Board directs AUI to make the appropriate adjustments in its compliance filing. 33
31. Consequently, given the time required to conduct a proper review and the amounts involved, the Board will not compel AUI to adjust its revenue requirement for the test years. However, should AUI propose to continue using the flow-through method to determine its income tax amounts for regulatory purposes, the Board directs AUI to consult with its income tax advisor to ascertain whether the E&S costs it has capitalized for income tax purposes would otherwise qualify as being deductible in the year incurred and provide the Board with the advisor's written opinion on the subject no later than the time of its next GRA. 34
32. The Board concurs with AUI that a deferral account is unnecessary, and directs AUI to reflect any changes in CCA rates in its compliance filing. 35

33. The Board therefore directs AUI to revise its common equity placeholder for 2006 to accord with the recent Board Order U2005-410 (2006 Generic Return on Equity Formula Result) and to reflect the revised number in its compliance filing. 35
34. The Board concurs with this revision and directs AUI to reflect a rate of 6.00% for 2003 New Debt in its compliance filing. 35
35. Therefore, the Board approves a deemed debenture placeholder amount of 6.7% for the \$30 million principal amount for 2000 Debt that is to be refinanced in 2005. The Board directs AUI to reflect this revision in its compliance filing, and the 6% for the 2003 New Debt of \$30,000,000. Upon approval of AUI's debenture application, the Board directs AUI to reflect this change in its revenue requirement and apply any change in the cost of debt at its next GRA..... 37
36. The Board therefore directs AUI to reflect the gain on sales of the Southeast District Office of \$22,500 as income in 2005..... 38
37. The Board directs AUI to revise its 2005-2006 GRA Phase I to reflect the Board's findings, conclusions and directions in this Decision and to re-file the amended GRA by December 16, 2005. The Board expects AUI in its re-filing to provide a summary of all adjustments made, including details of any associated impact on NWC, taxes, depreciation, or any other related areas. 39