



RP-2002-0135

IN THE MATTER OF the *Ontario Energy Board Act*,
1998, S.O. 1998, C.15, Schedule B;

AND IN THE MATTER OF an Application by Enbridge Gas
Distribution Inc., formerly The Consumers' Gas Company
Ltd., for an order or orders approving or fixing rates for the
sale, distribution, transmission and storage of gas for its 2002
fiscal year;

AND IN THE MATTER OF a proposal by Enbridge Gas
Distribution Inc., formerly The Consumers' Gas Company
Ltd., to establish a Deferred Income Tax Deferral Account and
other related matters.

BEFORE:

Howard Wetston, Q.C.
Chair and Presiding Member

Paul Vlahos
Member

DECISION AND ORDER

December 3, 2003

In the EBO 179-14/15 proceeding, Enbridge Gas Distribution Inc. (EGDI) sought Board approval to include its water heater rental program as part of the core utility. EGDI intended to wind down the rental program which would trigger a requirement to pay taxes that had been previously deferred. EGDI proposed to recover those taxes from ratepayers, to the extent that they could not be recovered from rental customers.

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In its decision, dated March 31, 1999, the Board rejected EGDI's request, on the basis that the rental program was an ancillary program that was not regulated by the Board. The Board's treatment of the rental program had focused on ensuring that it was not subsidized by ratepayers. The Board determined that any deferred taxes associated with the rental program that became payable would be the responsibility of the Company and not ratepayers. However, by comparing the rate of return on the rental program with the Board approved rate of return for the utility, the Board recognized that ratepayers did benefit to some extent from the rental program. On a forecast basis, the Board found that between 1989 and 1998 there was a total sufficiency from the program of \$50 million, after tax.

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On June 11, 1999, EGDI filed a motion asking the Board to vary its decision. The motion was denied on August 17, 1999.

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Then, on October 15, 1999, EGDI brought an application for judicial review to the Divisional Court, Ontario Superior Court of Justice.

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On October 1, 1999, EGDI transferred the rental business to its affiliate, Enbridge Services inc. The rental business was eventually sold to Centrica North America on May 7, 2002.

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While the application for judicial review was still pending, EGDI sought to draw down from the notional account as part of the RP-1999-0001 proceeding, dealing with fiscal 2000 rates. In its decision, dated December 16, 1999, the Board denied the Company's request to recover the requested amount for deferred taxes in the test year on the basis that it was not clear if and how the rental program would be wound down thereby triggering incremental taxes payable within the affiliate.

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In RP-2000-0040, dealing with fiscal 2001 rates, EGDI requested a deferral account to recover \$50 million, after taxes, over ten years. The Board removed the matter from the Issues List because the Company's application for judicial review was still pending.

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EGDI's application for judicial review to the Divisional Court was denied on December 19, 2001.

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Subsequently, in RP-2001-0032 dealing with fiscal 2002 rates, EGDI requested a deferral account to recover \$50 million, after taxes, over nine years. As part of an ADR agreement, the parties agreed that they would ask the Board to initiate a separate proceeding to deal with this issue. The Board accepted the ADR agreement.

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The present proceeding was established to deal with the issue, upon the completion of the RP-2001-0032 proceeding. The parties to this proceeding are EGDI, IGUA, CAC and VECC.

EGDI seeks to recover \$50 million in rates based on its interpretation of the Board's original decision in EBO 179-14/15. EGDI's claim is opposed by IGUA, CAC and VECC ("the Intervenor").

In order to deal with EGDI's claim, the Board issued a procedural order. A joint submission was received from the Intervenor. EGDI filed a responding submission and the Intervenor filed a reply submission.

The position of IGUA, CAC and VECC

The Intervenor argued that EGDI's original request was for contingent relief, in that EGDI wanted to run the rental program as part of the core utility, and to the extent that it could not recover deferred taxes from the rental customers as they became payable, it wanted to collect those amounts in rates.

The Intervenor submitted that it is clear that the Board had rejected EGDI's request and granted different relief which was also contingent. They argued that the Board's decision was clear that the \$50 million notional utility account was to be drawn on only as taxes became payable. This is reinforced in the RP-1999-0001 Board decision, in which the Board rejected EGDI's request to draw on the notional utility account in the absence of being able to ascertain whether any taxes were actually payable.

The Intervenor further argued that the Board did not find that EGDI was unconditionally entitled to receive \$50 million from the ratepayers. EGDI's request to recover the full \$50 million from ratepayers is inconsistent with its original request, the Board's decision, and also the Board's approach in RP-1999-0001.

The Intervenor contended that after the rental program assets were transferred from the utility to an affiliate, they were again transferred to another affiliate and operated on a wind down basis, triggering the requirement to pay previously deferred taxes. The Intervenor submitted that this is an artificial wind down that was intended to trigger the requirement to pay taxes in order to draw upon the notional utility account, and under those circumstances, the Board should not allow recovery of those taxes from that account. If the assets had been kept as part of the ongoing rental program operated by the first affiliate, the obligation to pay taxes would not have been triggered because of the continuing investment in the rental program by that affiliate.

The Intervenor argued that the appropriate interpretation to give to EBO 179-14/15 is that it was not an unconditional grant of \$50 million after taxes, but rather an obligation on ratepayers to pay up to \$50 million tied to and conditional upon the future payment of income taxes. This was to prevent a possible erosion of returns in future years as result of the inability of the rental equipment business to completely cover its deferred tax liability on a stand-alone basis. The Intervenor concluded that EGDI is only entitled to draw on the notional utility account for any taxes that became

payable between October 7, 1999 (the date in which the assets were transferred out of EGDI to an affiliate) and May 7, 2002 (the date of the sale of the rental assets to a third party).

The Intervenor also took the position that EGDI's ability to draw on the notional utility should be limited to the amount of deferred taxes that would have been payable, had the assets been kept within the first affiliate and operated on an ongoing basis, rather than transferred to a second affiliate and operated on a wind down basis.

The position of EGDI

EGDI argued that the Board's method of giving recognition to the benefits received by ratepayers in the rental program was to allow the Company to establish a notional utility account in the amount of \$50 million, after tax. This notional utility account is not a deferred taxes account. Instead it is an account that recognizes the Board's finding of a \$50 million sufficiency from the rental program.

EGDI contended that in setting up the notional utility account, the Board was addressing the question of "how" the \$50 million of ratepayers benefits could be recovered and not "whether" the benefits could be recovered in rates.

EGDI pointed out that the decision of the Divisional Court in EGDI's judicial review application held that the Board was required to balance the impact of deferred taxes between ratepayers and the shareholder and that the Board's balancing was just and reasonable. EGDI argued that IGUA, CAC and VECC want to upset this balancing by depriving the Company of any opportunity to recover the \$50 million of ratepayer benefits recorded in the notional utility account.

EGDI indicated that, in the aftermath of the Board's EBO 179-14/15 decision, it has treated the \$50 million notional utility account as a regulatory asset. To the extent that the Company cannot recover the full \$50 million, there will be an equivalent reduction in the net after-tax income of the Company.

EGDI argued that the fact that the rental assets were transferred into an affiliate and operated in a wind down mode is completely consistent with the Company's original proposal, which was to wind down the rental program as part of the core utility.

EGDI held that the EBO 179-14/15 decision does not contemplate that the sale of the rental program to a third party on May 7, 2002 would affect the recovery of the amount recorded in the notional utility account.

EGDI submitted that it would be inappropriate to deny recovery of the \$50 million of ratepayer benefits recorded in the notional utility account because of the sale to a third party. The fact of the sale does not affect the \$50 million of benefits that were delivered to the ratepayers from the rental program and which the Board had determined should be recognized.

EGDI noted that, in the EBO 179-14/15 decision, the Board undertook the balancing of interests and found that the gas distribution ratepayers should pay back \$50 million of the benefits that they had received from the rental program. The mechanism created by the Board for the recovery of the \$50 million was a notional utility account against which the Company could draw as deferred taxes became payable. Since this mechanism is no longer available because of the sale of the assets, the Company requests direction from the Board as to what mechanism for recovery should now be used.

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Reply by IGUA, CAC and VECC

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In their reply, the Intervenors reiterated their argument that the Board clearly linked the notional utility account to the payment of deferred taxes as they became due. When the Board, in its reasons for decision, discussed the option of selling the rental business to a third party, the Board specifically noted that “any proceeds from such a sale would be available to address the related tax consequences”. This reflects the Board’s intention that the notional utility account was to be drawn upon only to the extent that it was necessary to do so to pay taxes.

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The Intervenors argued that the fact that EGDI recorded the \$50 million notional utility account as a regulatory asset is not relevant since it did so without consultation and the appropriateness of this treatment was never determined by the Board. EGDI’s decision to record the \$50 million as a regulatory asset was done after the fact and is not relevant to the issue of the interpretation to be given to the EBO 179-14/15 decision.

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The Intervenors argued that, in striking a balance, the Board awarded EGDI conditional relief. EGDI now seeks to convert that conditional relief into an absolute obligation for ratepayers to pay \$50 million after taxes. There is nothing in the Divisional Court decision that suggests that the Court’s view was that ratepayers were under an absolute and unconditional obligation to pay \$50 million after taxes as a result of the Board’s decision.

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The Intervenors argued that the triggering of the requirement to pay taxes that resulted from the transfer of the rental program assets to a second affiliate, which then operated them in a wind down mode, is a product of a strategy that gives rise to a windfall gain if those taxes are to be recovered from the notional utility account.

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The Intervenors submitted that the Board found that ratepayers should share the potential exposure to pay taxes previously deferred up to a maximum of \$50 million. As a result of the sale of the rental assets to a third party, there is no further exposure to taxes and so there should be no further payment from the notional deferral account beyond what is required to recover taxes that became payable prior to the sale.

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Board Findings

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This is a somewhat unusual proceeding. We are not sitting on a review or appeal of the original decision. Rather, we have been asked to interpret a Board decision so as to give it effect.

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The pivotal issue the Board must decide is whether the creation of the notional deferral account is linked to the payment of income taxes in future years, or whether it represents an unconditional obligation by EGDI's ratepayers to pay an after tax amount of \$50 million as compensation for past benefits received from the rental program.

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At paragraph 3.2.2 of the EBO 179-14/15 decision, the Board quoted EGDI's application with respect to the regulatory treatment of the rental program. It read:

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The recovery from ratepayers in due course on a taxes payable or "flow through" basis of the Company's unrecorded deferred tax income tax liability in relation to the program as at September 30, 1999 ...

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At paragraph 3.3.19 of its EBO 179-14/15 decision, the Board stated:

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It therefore appears to the Board that utility ratepayers have benefited from the rental program over the years, and that the shareholder has absorbed some costs. While finding that ratepayers should not be responsible for the deferred tax liability, per se, related to the rental program, the Board believes that there should be some recognition of the benefits they have received in the past. The Board therefore would accept the provision of a notional utility account in the amount of \$50 million, after tax, to allow the shareholder to use the value of these past ratepayer benefits to pay a portion of the deferred taxes associated with the rental program as they become due. It is up to the Company to determine the future of the program, but whatever that choice, the notional account can be drawn down to pay deferred taxes up to \$50 million. [Emphasis added]

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In paragraph 3.3.20, the Board identified three options that the company might consider: (i) continue to operate the rental program as a non-utility program for the time being; (ii) wind down the program as a non-utility program; or (iii) transfer the assets to an affiliate or sell the program to a third party.

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In relation to option (iii), the Board noted:

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In these circumstances, any proceeds from the sale or transfer would be available to address the related tax consequences. To the extent that the Company proposes to utilize any or all of the notional account as well, the Board's approval of the rate-making consequences would be required. The Company should be aware that, under this option, consideration of 'rate shock' may dictate the degree of amortization of the amount to be reflected in rates going forward.

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In paragraph 3.3.21, the Board stated:

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In any of these cases [three options], the Company may draw on the notional account to pay deferred taxes as they become due. [Emphasis added]

EGDI first sought to draw against the notional account in RP-1999-0001. In paragraph 3.1.6 of its RP-1999-0001 decision, the Board stated:

Payment of the deferred taxes associated with the rental program arises according to the Company from a wind down mode. However, the testimony by the Company's witness is neither definitive that the rental program will be "wound down" nor clear as to how it will be "wound down" thereby triggering incremental taxes payable within the affiliate. The Board is not prepared to consider the other arguments by the parties unless there is a better understanding on these issues, which must come from a more complete and clear record. The Board therefore denies the Company's request to recover the requested amount for deferred taxes in the test year.

The above excerpts represent the core of the Board's decisions in this matter. We are of the opinion that these reasons do not support EGDI's view that the Board's decision in EBO 179-14/15 represents an unconditional obligation for the ratepayers to pay \$50 million, after tax. The Board clearly intended that EGDI would be able to recover from the notional account only as deferred taxes became payable, and only up to \$50 million, after tax.

The Board therefore confirms that draws against the notional account are limited to \$50 million, after tax, and are conditional upon deferred taxes associated with the rental program becoming payable.

The Intervenor argued that EGDI's ability to draw on the notional utility should be limited to the amount which would have been payable in taxes, had the assets been kept within the first affiliate and operated on an ongoing basis, rather than transferred to a second affiliate and operated on a wind down basis. In our view, the language in the Board's EBO 179-14/15 decision does not support this interpretation. This interpretation would preclude, in effect, EGDI and its affiliates from engaging in normal tax planning in order to optimize exposure to deferred tax liability. In fact, one of the options identified by the Board in the EBO 179-14/15 decision specifically contemplates transferring the rental program assets to an affiliate or selling to a third party.

The rental program assets have been sold to a third party. As such, neither EGDI nor its affiliates bear any further tax liability post the date of the sale in relation to those assets.

The Board finds and orders that EGDI is entitled to recover from the notional utility account an amount, after taxes, equal to the deferred taxes that became payable between October 7, 1999 (the date in which the assets were transferred out of EGDI to an affiliate) and May 7, 2002 (the date of the sale of the rental assets to a third party). EGDI may seek to recover such amount, appropriately verified, in its next rates application. The Board expects EGDI to ensure that its request for recovery includes consideration of any potential for rate shock.

The Board will issue its decision on costs at a later time.

DATED at Toronto, December 3, 2003

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Howard Wetston, Q.C.
Chair and Presiding Member

Paul Vlahos
Member