



IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473

and

An Application by Terasen Inc.
(formerly known as BC Gas Inc.)
for Approval of Sharing Reduced Tax Savings
between Terasen Inc. and Terasen Gas Inc.
(formerly known as BC Gas Utility Ltd.)

BEFORE: P. Ostergaard, Chair)
K.L. Hall, Commissioner) May 16, 2003
R.H. Hobbs, Commissioner)

O R D E R

WHEREAS:

- A. On September 21, 1998, Terasen Gas Inc. ("the Utility") informed the Commission of a tax loss utilization plan ("TLUP") that the Terasen group of companies planned to put in place in late 1998 or early 1999; and
- B. The Utility had annual taxable income and several non-regulated businesses ("NRBs") had tax losses. The TLUP involved inter-company loans from the NRBs to the legal entity of the Utility to create deductible interest expense in the legal entity of the Utility and taxable interest income in the NRBs; and
- C. All transactions in the TLUP were considered to be non-utility and were to have no adverse impact on the Utility nor its customers; and
- D. On November 27, 1998, the Utility requested an acknowledgement letter from the Commission confirming that the TLUP had been reviewed and that no concerns had been raised; and
- E. On December 10, 1998, the Commission issued the requested acknowledgement letter to the Utility; and
- F. Income tax rates declined from 2000 to 2003 and on March 18, 2003, Terasen Inc. applied to the Commission for approval to adjust the deferral accounts of the Utility to share equally the reduced tax

savings that resulted from the effect of the non-utility TLUP in concert with unanticipated higher gas costs and tax rate reductions (“the Application”); and

- G. The Application stated that deferring the recovery of higher gas costs, recording the additions to the Gas Cost Reconciliation Account and the Revenue Stabilization Adjustment Mechanism on a net-of-tax basis and the declining income tax rates from 2000 to 2003 provided utility customers with tax savings of \$13.3 million and the Utility shareholders with tax savings of \$4.8 million; and
- H. The Application proposed that Utility customers and shareholders should share equally the difference in tax savings of \$8.5 million. The proposed sharing would result in the Utility foregoing \$4.25 million of the tax benefit by an adjustment to the Utility’s deferral accounts. The shareholder would increase its tax saving by \$4.25 million to \$9.05 million; and
- I. A Commission staff information request was issued on April 17, 2003 and responses were filed on May 6, 2003; and
- J. The Commission has reviewed the Application and responses and considers that a determination is required.

NOW THEREFORE as set forth in the Reasons attached as Appendix A, the Commission finds that the Application is without merit and is denied.

DATED at the City of Vancouver, in the Province of British Columbia, this 22nd day of May 2003.

BY ORDER

Original signed by:

Peter Ostergaard
Chair

Attachment

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REASONS FOR DECISION

The Terasen Inc. Application relates to the use of deferral accounts and the recovery of deferred expenditures in customers' rates. In order to smooth the rate impacts of certain volatile expenses such as the commodity cost of natural gas, the Commission approves the creation of deferral accounts, including the Gas Cost Reconciliation Account ("GCRA") and the Revenue Stabilization Adjustment Mechanism ("RSAM") account, which effectively remove the actual expenditures from the determination of customer rates. The Commission then approves the amortization of these expenditures over a number of years for recovery from customers. Since the expenditures are recognized as deductions for income tax purposes, the accounts are recorded on a net-of-tax basis. That is, the Utility reduces the gross additions to the deferral account for the current year by the tax saving at the prevailing income tax rate for the current year. This net-of-tax treatment keeps the shareholders whole and compensates them for the financing of the net of tax. Since the subsequent amortization is not recognized by the Canada Customs and Revenue Agency as a deductible expense, in order to keep the Utility whole, it is grossed up at the then-prevailing income tax rate. If the income tax rates decline from the time that a deferred cost is incurred to when it is amortized into rates, a smaller rate increase is required from customers in order for the Utility to pay income taxes at the current rate on the amortized amount.

As noted in the March 18, 2003 Application, the Utility followed the approved practice of recording the deferrals on a net-of-tax basis. The Application calculates that customers benefited by \$13.3 million for the net-of-tax treatment of deferred expenditures and the decline in income tax rates from 2000 to 2003. However, during the same period the Utility initiated a Tax Loss Utilization Plan ("TLUP") to create greater tax-deductible expenses in the Utility in order to create income in related companies which otherwise would have had tax losses. Although the Utility did not believe that it required Commission approval for the TLUP, at the request of Commission staff, it wrote to the Commission on September 21, 1998 explaining that the plan is an acceptable method for transferring tax losses within a related corporate group. The letter explained that the transactions are excluded from the Regulated Utility tax expense calculation and that it would have "no adverse impact on the Regulated Utility nor its customers". At the Utility's request, in a December 10, 1998 letter, the Commission acknowledged that Commission staff had reviewed the TLUP transactions, and that no concerns have been raised.

On March 18, 2003, the Utility's parent company informed the Commission that as a result of high gas cost deferrals and the TLUP, the Utility had excessive tax deductions leading to tax loss carry forwards. Because Federal and Provincial corporate tax rates decreased during the period, the value of loss carry forwards decreased. The parent company then applied to the Commission for approval to adjust the Utility's deferral accounts to share the reduced tax savings. The Application stated that the net-of-tax deferral account treatment provided Utility customers with tax savings of \$13.3 million but only a \$4.8 million tax saving will be realized. This sharing would result in the customers foregoing \$4.25 million of their tax savings.

After a review of the Application and subsequent information, the Commission determines that the net-of-tax deferral account mechanism operated properly for the benefit of the Utility and its customers, that the related group of companies had tax planning options other than TLUP, and that the TLUP did not provide any tax savings for Utility customers while the related group of companies received substantial tax savings.

The March 18, 2003 Application is denied.