



Memorandum

September 12, 2008

FROM: Darcy Mazurkewich, Manager Audit and Compliance

TO: Willie Grieve, Chair, Alberta Utilities Commission

REGULATORY AUDIT OF ALTAGAS UTILITIES INC.

Please find attached the audit report resulting from the recently completed Regulatory Audit of AltaGas Utilities Inc. (AUI) as well as management's response to the audit report.

The Audit Team determined that AUI demonstrated in all material respects compliance with their Inter-Affiliate Code of Conduct and the Gas Code of Conduct Regulation.

As noted in the report, AUI management and staff provided us with their full cooperation throughout the audit.

If you have concerns about the attached, please call me at 403.592.7729.

A handwritten signature in blue ink, appearing to read "D. Mazurkewich", is written over the typed name.

Darcy Mazurkewich
Manager, Audit and Compliance
Audit and Compliance Group, Utilities Division

CC: Earle Tuele, President, AltaGas Utilities Inc.
Bob Heggie, Chief Executive, Alberta Utilities Commission

September 11, 2008

Mr. Darcy Mazurkewich, CMA
Manager, Audit and Compliance
Alberta Utilities Commission
Fifth Avenue Place, 4th Floor
425 – 1 Street SW
Calgary AB T2P 3L8

Dear Mr. Mazurkewich:

**Re: Alberta Utilities Commission Regulatory Audit Report #2008-002
Audit in Respect of Compliance with the Inter-Affiliate Code of Conduct and Gas Code of
Conduct Regulation for the Year Ended December 31, 2007**

Thank you for providing AltaGas Utilities with the opportunity to comment on the draft Regulatory Audit Report #2008-002. It is our understanding that this response will be attached to the final version of the report and posted to the Alberta Utilities Commission website.

AltaGas Utilities management has reviewed the report and believes that it is complete and accurately reflects the findings that were communicated to us both during and following the audit. We are committed to complying with our Inter-Affiliate Code of Conduct and the Gas Utilities Act Code of Conduct Regulation and are pleased that the audit findings and conclusion indicate that AltaGas Utilities is performing to the satisfaction of the Alberta Utilities Commission.

On behalf of AltaGas Utilities, I thank the Alberta Utilities Commission for accommodating our request to perform the Gas Utilities Act Code of Conduct Regulation audit and for effectively coordinating it with the Inter-Affiliate Code of Conduct audit. We are appreciative of the professional manner in which the audit team performed its duties and the open communication with us that was maintained throughout the process.

Yours truly,

AltaGas Utilities Inc.



Earle Tuele
President



AltaGas Utilities Inc.

Audit in Respect of Compliance with the
Inter-Affiliate Code of Conduct and
Gas Code of Conduct Regulation
for the Year Ended December 31, 2007

September 2008

Audit Team:

Darcy Mazurkewich
Nick Iannone
Joel Thompson
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ALBERTA UTILITIES COMMISSION

Regulatory Audit Report #2008-02: AltaGas Utilities Inc.
Regulatory Audit in Respect of Compliance with the
Inter-Affiliate Code of Conduct and Gas Code of Conduct Regulation
for the Year Ended December 31, 2007

September 2008

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1 UTILITY OVERVIEW

AltaGas Utilities Inc. (AUI) distributes natural gas to approximately 65,000 residential, rural, and commercial customers in over 90 communities throughout Alberta. AUI has approximately 170 staff and over 19,800 kilometres of pipeline.

AUI is a direct wholly-owned subsidiary of AltaGas Utility Holdings Inc., which is in turn a direct wholly-owned subsidiary of AltaGas Utility Group Inc., a public company listed on the Toronto Stock Exchange. AltaGas Income Trust and its subsidiary entities were deemed for regulatory purposes to be affiliates of AUI. This is because AltaGas Income Trust previously through an indirect relationship owned 100% of AUI, and continues to have an indirect ownership relationship with AUI as a result of a restructuring approved by the Alberta Energy and Utilities Board (the Board) in late 2005,¹ whereby AltaGas Income Trust now owns 19.6% of the common shares of AltaGas Utility Group Inc.

2 OBJECTIVE AND SCOPE

The audit was conducted for the Alberta Utilities Commission (Commission) with the objective of providing to the Commission an opinion regarding AUI's compliance with its Inter-Affiliate Code of Conduct (IACC) and Alberta Regulation 183/2003 - Gas Code of Conduct (GCCR) (together the Codes).

The Audit Team through the development and application of an audit plan can obtain reasonable assurance of AUI's compliance to the Codes. Based on that reasonable assurance, the Audit Team can express an opinion that AUI has or has not demonstrated a respect for the spirit and intent of the Codes.² The audit procedures included examining, on a test basis, evidence supporting compliance, and evaluating the overall compliance with these criteria (see following sections for greater detail of the procedures).

The audit period covered the year ended December 31, 2007. The audit planning and fieldwork occurred during the period from mid-May to the end of June.

The primary focus of the audit scope was the testing of AUI's adherence to the measures in its Compliance Plans (Plans). Prevention and detection controls (i.e. the measures) in AUI's Plans are intended to assist AUI in ensuring its compliance, and thereby provide the Commission and other stakeholders some assurance that AUI is compliant with the spirit and intent of the Codes. The secondary focus of examining AUI's inter-affiliate accounts and transactions was performed in order to test the effectiveness of the financial measures in AUI's Plans.

Excluded from the scope of the audit, was a determination of the prudence of AUI's inter-affiliate service agreements and transactions. This was because i) the Audit Team has no professional competence to determine the value of the services, and ii) prudence is generally examined during hearings to decide upon AUI's General Rate Applications.

¹ Decision 2005-112 - AltaGas Utility Holdings Inc. Request for Approval of Share Transfer (Application No. 1408750) (Released: October 14, 2005)

² The Commission is not bound by the findings of the Audit Group with respect to any future hearings or proceedings in which an issue of compliance by the utility is raised, and which was the subject matter of an audit.

The audit plan, fieldwork, and audit report may differ in certain respects with procedures used under Generally Accepted Auditing Standards because a regulatory compliance audit is only intended to provide assurance to the Commission. While AUI is responsible to comply with its Codes, the Commission is responsible for approving exemptions from the Codes as well as approving changes to the Plans, and monitoring AUI's compliance reports for potential issues.

3 INTER-AFFILIATE CODE OF CONDUCT

In 2000, the Board predecessor to the Commission³ received concurrent applications from the ATCO group of companies (the ATCO Group) dealing with Inter-Affiliate Code of Conduct issues.⁴ The Board also received communications indicating that other utilities had inter-affiliate concerns which needed to be addressed. During the final argument of the ATCO hearing, the Board asked for comments from interested parties, on the relative advantages of conducting a generic hearing to finalize a code of conduct rather than proceeding by drafting codes on a company-by-company basis. In a letter dated December 18, 2001, the Board advised the interested parties that it would not proceed with a generic hearing, but instead would proceed to establish a code of conduct for the ATCO Group and where appropriate, reflect those findings in subsequent decisions. This process resulted in Decision 2003-040⁵ which contained the ATCO Group Inter-Affiliate Code of Conduct (Code).

In Decision 2003-040,⁶ the Board outlined the purpose of having a Code and the four parameters or principles supporting the Code.

The purpose of this Code is to establish standards and conditions for interaction between each ATCO Utility and its Utility and Non-Utility Affiliates. This Code attempts to anticipate and adjust for the potential misalignment of interest between shareholders and Utility customers occasioned by Affiliate interactions through the establishment of parameters for transactions, information sharing and the sharing of services and resources, while permitting economies of scale and operating efficiencies.

These parameters are intended to:

- (a) prevent Utilities from cross-subsidizing Affiliate activities;
- (b) protect confidential customer information collected in the course of providing Utility services;
- (c) ensure Affiliates and their customers do not have preferential access to Utility services; and
- (d) avoid uncompetitive practices between Utilities and their Affiliates, which may be detrimental to the interests of Utility customers.

³ This audit report is issued under the jurisdiction of the Commission. Readers are reminded that all references to past decisions issued by or directions provided by the Commission's predecessor, the Board, are indicated as such in accordance with section 80(2) of the *Alberta Utilities Commission Act*, S.A. 2007, c. A-37.2 (AUC Act).

⁴ Application 2000234 filed jointly by ATCO Electric Ltd. (AE) and ATCO Gas and Pipelines Ltd. was with respect to their relationships and transactions with other regulated and non-regulated affiliates within the ATCO group of companies. Application 2000233 filed by AE was with respect to affiliate transactions for the 2001/2002 test period.

⁵ Decision 2003-040 - ATCO Group Affiliate Transactions and Code of Conduct Proceeding Part B: Code of Conduct (Application No. 1237673) (Released: May 22, 2003)

⁶ Decision 2003-040, page 38

In Order U2004-416,⁷ the Board approved AUI's Code which was based on the ATCO Group Code. Section 7.5 of the Code requires AUI to have a Compliance Plan (Plan) to:

detail the measures, policies, procedures and monitoring mechanisms that the Utility will employ to ensure its full compliance with the provisions of the Code by the Utility, its directors, officers, employees, consultants, contractors and agents, and by Affiliates of the Utility with respect to the interactions of the Affiliates with the Utility.

In Order U2005-342,⁸ the Board approved AUI's Plan based on the ATCO Group Plans.

AUI is the sixth utility to be audited by the Audit Team for compliance with its Code (see Audit Report 2008-001).⁹

In the normal course of business, AUI has inter-affiliate transactions relating to:

- fees for administration, management and other services;
- gas purchases for resale;
- gas operations and gas portfolio management;
- transportation services; and
- financial charges.

During 2007, inter-affiliate transactions amounted to \$88.9 million of which gas purchases, financial charges and other services accounted for \$82.5 million, \$4.0 million and \$2.4 million respectively.

The following represents the significant audit procedures performed for the Code and Plan of the utility. The Audit Team:

- reviewed relevant Board Decisions and Utility Orders to identify the related regulatory requirements and directives, and then developed compliance audit tests.
- reviewed committee meeting minutes for evidence that actions specified in the measures of the Plan were completed, along with the timeliness of the actions taken.
- selected and reviewed a sample of attestation and compliance certificates signed by employees, officers and directors to verify completeness, accuracy, and timeliness.
- reviewed with management, the internal procedures the utility has in place to enable them to sign certificates of attestation.
- reviewed and examined the control procedures used to ensure customer confidentiality.
- selected and tested a sample of service agreements to determine that they were properly approved, and in accordance with the requirements defined in the utility's Code.
- verified the accuracy of the quarterly and annual compliance reports.
- analyzed and reconciled data in the relevant accounts to utility management reports, utility financial statements, and annual information filed with the Board.

⁷ Order U2004-416 - AltaGas Utilities Inc. Inter-Affiliate Code of Conduct Filing (Application 1365034) (Released: December 1, 2004)

⁸ Order U2005-342 - AltaGas Utilities Inc. Inter-Affiliate Code of Conduct Compliance Plan (Application No. 1391147) (Released: August 29, 2005)

⁹ Audit Report 2008-001 – Inter-Affiliate Code of Conduct Audit

- selected a sample of inter-affiliate transactions for the audit period, and carried out tests to verify that the selected items were:
 - properly supported by a service agreement or other appropriate documentation;
 - valued in accordance with the Code and the applicable service agreement;
 - recorded in the correct entity, account and time period;
 - properly authorized; and
 - in accordance with regulatory directives.

4 GAS CODE OF CONDUCT REGULATION

In 2003 the Alberta Government under the *Gas Utilities Act* issued the GCCR. The purpose of the GCCR is to prescribe the behaviours for Gas Distributors, Default Supply Providers, and Retailers. The four behaviours on which the regulation focuses are as follows:

- a) equal treatment of customers;
- b) confidential treatment of Customer Information;
- c) equal treatment of retailers (by gas distributors); and
- d) preventing unfair competitive advantages.

The Commission is responsible to oversee Gas Distributors, Default Supply Providers, and affiliated Retailers, this oversight includes the approval of Compliance Plans, approval of auditors and audit plans, the monitoring of compliance, and deciding on exemption requests.

In Decision 2004-085,¹⁰ the Board deemed AUI to have an affiliate relationship with two subsidiary entities of AltaGas Income Trust, because they provide retail energy services within Alberta. In addition the Board directed AUI to file a Compliance Plan by December 1, 2004. Issued concurrently with Decision 2004-085, was Decision 2004-084¹¹ in which the Board directed both ECNG LP and PremStar to file Compliance Plans for approval as AUI's deemed affiliated retailers.

The Board approved AUI's GCCR Compliance Plan in Decision 2005-097.¹²

Division 2 of the GCCR specifies the annual audit requirements that AUI must adhere to. During 2007, AUI requested an exemption to parts of the audit requirement and requested that the Commission's Audit and Compliance Group perform the compliance audit. AUI's request was approved by the Commission in Order U2008-176.¹³

¹⁰ Decision 2004-085 - AltaGas Utilities Inc. Temporary Exemption from Requirement to Obtain Board Approval for Compliance Plan In Accordance with Section 30(1) of the Gas Code of Conduct Regulation (Application No. 1359886) (Released: September 29, 2004)

¹¹ Decision 2004-084 - ECNG Limited Partnership Temporary Exemption from Requirement to Obtain Board Approval for Compliance Plan In Accordance with Section 30(1) of the Gas Code of Conduct Regulation (Application No. 1359872) (Released: September 29, 2004)

¹² Decision 2005-097 - AltaGas Utilities Inc. Gas Code of Conduct Regulation Compliance Plan (Application No. 1372823) (Released: August 30, 2005)

¹³ Order U2008-176 (Other Utilities - Exemption) - AltaGas Utilities Inc. Appointment of Auditor for Gas Code of Conduct Regulation Compliance Audit (Application No. 1571666)(Released: May 20, 2008)

The following represents the significant audit procedures performed for the GCCR audit of AUI. The Audit Team:

- reviewed the GCCR, relevant Board Decisions, and AUI's Plan to develop audit procedures for testing AUI's compliance.
- reviewed the minutes of the Compliance Plan Committee meetings for evidence that actions specified in the measures of the Plan were completed, along with the timeliness of the actions taken.
- selected and reviewed a sample of attestation and compliance certificates signed by employees, officers and directors to verify completeness, accuracy, and timeliness.
- reviewed with management, the internal procedures the utility has in place to enable them to sign certificates of attestation.
- reviewed and examined the control procedures used to ensure customer confidentiality.
- determined that the annual compliance report is supported by the documentation reviewed in the other procedures.

5 CONCLUSION

Based on the scope of the audit and the audit procedures set out above, the Audit Team is of the opinion that AUI complied in all material respects with its Inter-Affiliate Code of Conduct and with Alberta Regulation 183/2003 – Gas Code of Conduct for the year ended December 31, 2007.

The Audit Team expresses its appreciation to the management and staff of AUI for their cooperation and assistance during the course of the audit.