RP-2001-0032

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

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

BEFORE: Sheila K. Halladay
Presiding Member

A.Catherina Spoel
Member

Bob Betts
Member

DECISION WITH REASONS

2002 December 13

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1. INTRODUCTION

1.1 THE APPLICATION

1.1.1 Enbridge Gas Distribution Inc., formerly, The Consumers' Gas Company Ltd., carrying on business as Enbridge Consumers Gas, ("ECG", the "Company" or the "Applicant") filed an application dated September 25, 2001 (the "Application") with the Ontario Energy Board (the "Board") under section 36 of the *Ontario Energy Board Act, 1998* (the "Act"), for an order or orders approving or fixing just and reasonable rates for the sale, distribution, transmission, and storage of gas for ECG's 2002 fiscal year commencing October 1, 2001 ("2002 Test Year"). The Board assigned file number RP-2001-0032 to the Application.

1.2 THE PROCEEDING

1.2.1 On October 15, 2001 the Board issued a Notice of Application, which was published and served in accordance with the Board's direction during the latter part of October 2001.

1.2.2 On November 16, 2001 the Board issued Procedural Order No. 1 establishing a two-phase proceeding. The Board determined that in the first phase, it would consider all of the issues contained in the Application, except for the Company's request for a review of the formula used to derive the rate of return on common equity ("ROE"). The Board would review the ROE formula in a subsequent phase.

1.2.3 Procedural Order No. 1 also provided the initial procedural schedule for the first phase: namely, written interrogatories to ECG, followed by an Issues Conference and an Issues Day on December 18 and 19, 2001, respectively.

1.2.4 Procedural Order No. 2, issued on December 28, 2001 established the Issues List, which is attached as Appendix A to this Decision with Reasons.

1.2.5 The Company completed its filing of new and updated evidence on January 29, 2002. In Procedural Order No. 3, dated February 4, 2002, the Board established an additional interrogatory process to deal with the Company's new and updated evidence.

1.2.6 Procedural Order No. 3 also made provision for Intervenors to present evidence by March 11, 2002 and for parties to submit written interrogatories on that evidence by March 18, 2002.

1.2.7 In response to Procedural Order No. 3, The Consumers Association of Canada ("CAC") submitted evidence prepared by Mark P. Stauft and the Green Energy Coalition ("GEC") submitted evidence prepared by Chris Neme.

1.2.8 On March 19, 2002 the Board issued Procedural Order No. 4 which provided for a Settlement Conference to begin on April 22, 2002, a Settlement Proposal to be filed on May 10, 2002, and proposed a hearing date of May 28, 2002. The Settlement Proposal was not filed until May 17, 2002.

1.2.9 Procedural Order No. 5 set June 4, 2002 as the date for the commencement of the oral hearing. The hearing took place over ten hearing days and concluded on June 21, 2002.

1.2.10 During the course of the hearing, the parties agreed to the following schedule for filing their respective written arguments: Applicant's Argument-in-Chief - July 5, 2002; Intervenors' Arguments - July 17, 2002; and Applicant's Reply Argument - July 29, 2002. In fact, arguments were filed on the following dates: the Applicant's Argument-in Chief - July 8, 2002; the Intervenors' Arguments - July 22, 2002; and the Applicant's Reply Argument - August 13, 2002.

1.2.11 Subsequent to the oral hearing the Board also received the following material on the dates indicated:

- July 26, 2002 — Affidavit of Stephen McGill
- July 31, 2002 — ECG Statement of Business Conduct
- August 1, 2002 — IGUA Further Argument
- August 2, 2002 — CAC Supplementary Argument
- August 29, 2002 — CEED Discussion Paper
- August 30, 2002 — CEED Further Argument
- September 5, 2002 — Letter from ECG disputing CEED's Further Argument
- September 9, 2002 — HVAC letter re CEED's Further Argument

- November 12, 2002 — IGUA Submission - Nova Scotia Power Decision
- November 15, 2002 — ECG Reply to IGUA Submission
- November 18, 2002 — IGUA Reply Submission

1.3 QUARTERLY RATE ADJUSTMENT MECHANISM

1.3.1 During the course of the proceeding, ECG made three separate applications to the Board and the Board issued interim orders to implement, effective January 1, 2002, April 1, 2002 and July 1, 2002, adjustments to ECG's commodity rates under a quarterly rate adjustment mechanism ("QRAM"). Each of these applications was substantially in the format approved by the Board, on a trial basis, as part of the settlement proposal (the "2001 Settlement Proposal") in the RP-2000-0040 proceeding for setting rates for ECG's 2001 fiscal year.

1.4 LATE PAYMENT PENALTY

1.4.1 By letter dated October 4, 2001 the Board directed ECG to review its late payment penalty ("LPP") in the context of this proceeding. The Ontario Court of Appeal decided on December 3, 2001 that "the Board will need to address an alternative mechanism for applying late payment penalties forthwith": *Garland v. Consumers' Gas Co. Ltd.* (2001), 57 O.R. (3d) 127 at 152.

1.4.2 By letter dated December 14, 2001 ECG advised the Board that it was studying two alternative approaches to revising the LPP. On January 10, 2002 ECG advised the Board that one option was to reduce the percentage for the one-time LPP from 5% to 2% and the other was to adopt a revolving credit style interest charge. ECG

proposed to implement its revised LPP on February 1, 2002. The Board assigned file number EB-2001-0837 (RP-2001-0032) to this application.

1.4.3 ECG recommended the first option as an interim measure; however, it indicated that a time-based charge -- the second option -- might be the preferred LPP option and that ECG might bring forward this option in the future.

1.4.4 ECG also proposed to establish an LPP Variance Account for the Test Year ("2002 LPPVA") to capture the variances between actual and forecast LPP revenues, together with the implementation costs of the revised LPP.

1.4.5 The Board accepted ECG's recommendation for a one-time penalty of 2%, on an interim basis, and in its Decision and Interim Order dated January 31, 2002 ordered that the new LPP would be effective February 1, 2002. The Board did not approve ECG's proposed 2002 LPPVA. Modifications to the Company's Rate Handbook to reflect the new LPP of 2% were approved by the Board as part of the QRAM proceeding to implement interim rates effective April 1, 2002.

1.5 PARTICIPANTS AND THEIR REPRESENTATIVES

1.5.1 Below is a list of participants and their representatives that were active either at the oral hearing or throughout the various other stages of the proceeding.

Board Counsel and Staff	Pat Moran Colin Schuch

Enbridge Consumers Gas	Jerry Farrell Helen Newland Marika Hare Tom Ladanyi
Canadian Manufacturers & Exporters ("CME")	Andrew Green Tom Moutsatsos Malcolm Rowan
Union Gas Limited ("Union")	Pat McMahon
Green Energy Coalition ("GEC")	David Poch Kai Millyard
The Ontario Association of School Business Officials (the "Schools")	Tom Brett
Heating, Ventilation and Air Conditioning Contractors Coalition Inc. ("HVAC")	Ian Mondrow
TransCanada PipeLines Limited ("TCPL")	Tibor Haynal
Consumers' Association of Canada ("CAC")	Robert Warren Julie Girvan
Vulnerable Energy Consumers Coalition ("VECC")	Michael Janigan Susan Lott Joyce Poon
Coalition for Efficient Energy Distribution ("CEED")	George Vegh Elisabeth DeMarco
Pollution Probe Foundation ("Pollution Probe")	Murray Klippenstein Jack Gibbons
Industrial Gas Users Association ("IGUA")	Peter C. P. Thompson

1.5.2 Gerry Haggarty, representing Superior Energy Management, requested and was granted late intervenor status to participate in the EB-2002-0364 proceeding, the QRAM effective July 1, 2002.

Witnesses

1.5.3 The following Company employees appeared as witnesses at the oral hearing:

Robert Bourke	Manager, Regulatory Accounting
Frank Brennan	Director, Energy Policy and Analysis
Dave Charleson	Manager, Strategic and Key Accounts
Pascale Duguay	Manager, Rate Research and Design
Janet Holder	Vice President, Operations
Tom Ladanyi	Manager, Regulatory Proceedings
Steve McGill	Manager, Customer Support Programs
Arunas Pleckaitis	Vice President, Opportunity Development
Rocco Riccio	Manager, Capital Knowledge Centre
Don Small	Manager, Gas Costs and Budget

1.5.4 In addition, the Company called the following witnesses:

Richard G. DeWolf	Senior Vice-President, Ziff Energy Group
Dr. W. G. Foster	Executive Vice-President, Foster Associates Inc.
Jim Bracken	Bracken Consulting

1.5.5 CAC called the following witness:

Mark P. Stauft	Independent Regulatory Consultant

1.6 THE SETTLEMENT PROPOSAL

1.6.1 A settlement proposal (the "Settlement Proposal") was filed with the Board on May 17, 2002 and updated pages were filed on June 14, 2002. A copy of the Settlement Proposal is attached as Appendix B to this Decision with Reasons.

1.6.2 The Settlement Proposal contained complete settlement for 26 issues and conditional settlement of the following four issues:

- Link Pipeline (Issue 2.2) ;
- Z-factor Budgeting Symmetry (Issue 6.3); and
- Customer Information System ("CIS") Z-Factor (Issues 9.1and 9.2).

1.6.3 There was no agreement in the Settlement Proposal to settle the following five matters, containing eight issues:

- Alliance and Vector Transportation Arrangements(Issue 2.1);
- System Gas Cost Allocations (Issues 2.3 and 2.4);
- ECG's Distribution Plant Work and Asset Management Solution ("DPWAMS ") Information Technology Project (Issue 4.2) ;
- Affiliate Outsourcing Arrangements (Issue 5.3); and
- Deferred Income Taxes (Issues 10.1,10.2 and10.3).

1.6.4 On June 4, 2002 counsel for ECG explained the Settlement Proposal to the Board; however, the financial impact statements relating to the Settlement Proposal were not available at that time, thereby delaying the Board's consideration of the Settlement Proposal.

1.6.5 At the oral hearing ECG advised the Board that the Company had revised its plans with respect to DPWAMS and, accordingly, there would be no rate impact as a result of DPWAMS for the 2002 Test Year. After hearing the submissions of the parties, the Board determined that dealing with the DPWAMS issue in this proceeding would be premature.

1.6.6 As part of the Settlement Proposal, ECG and the other parties requested that the Board deal with the Deferred Income Taxes (Issues 10.1,10.2 and 10.3) in a separate phase of this proceeding or a separate proceeding. In accepting the Settlement Proposal, the Board indicated that it would issue a procedural order to establish a separate proceeding to deal with the deferred taxes issues in due course.

1.6.7 ECG filed the financial impact statements relating to the Settlement Proposal on June 7, 2002. The Board reviewed the financial impact statements and on June 14, 2002, accepted the financial consequences of the Settlement Proposal for rate-making purposes for the 2002 Test Year. The financial statements reflecting the financial impact of the Settlement Proposal and forming the basis of the final rates are attached as Appendix C to this Decision with Reasons.

1.6.8 On July 12, 2002 ECG filed a letter with the Board withdrawing its request for a review of the formula used to derive ROE in this proceeding and on July 17, 2002 filed a letter with the Board requesting that the Board's order with respect to rates for the 2002 Test Year be made final. As a result it will not be necessary for the Board to hold a subsequent phase of this proceeding to deal with the ROE issue.

1.6.9 The Board issued its Final Rate Order for the 2002 Test Year on July 25, 2002. The new rates became effective on August 1, 2002 and included a retroactive adjustment to October 1, 2001, the beginning of the 2002 Test Year.

1.6.10 As a result of the Board's acceptance of the Settlement Proposal and the Company's decision on DPWAMS, the Board notes that none of the issues dealt with in the oral hearing had a direct impact on the determination of rates for the 2002 Test Year. This Decision with Reasons deals with the following issues, which were the subject of the oral hearing:

- Alliance and Vector (Issue 2.1);
- Cost allocation of Gas Supply Management Costs (Issues 2.3 and 2.4); and
- Affiliate Outsourcing (Issue 5.3).

1.6.11 In addition, in Chapter 6, the Board has made comments on additional matters.

1.6 CHANGE OF NAME

1.6.12 The Company informed the Board that effective July 25, 2002 the legal name of The Consumers' Gas Company Ltd. was changed to Enbridge Gas Distribution Inc. For ease of reference, however, in this Decision with Reasons, the Board continues to refer to Enbridge Gas Distribution Inc. as "ECG", the "Company", or the "Applicant", since these are the terms that were used throughout the proceeding.

1.7 SUBMISSIONS AND EXHIBITS

1.7.1 Copies of the evidence, exhibits, arguments, and transcripts of the proceeding are available for review at the Board's offices.

1.7.2 The Board has considered the evidence, submissions and arguments in the proceeding, but has summarized the evidence and the positions of the parties only to the extent necessary to provide context for its findings.

1.7.3 The Board, with industry participation, has developed standards and processes for the electronic regulatory filing ("ERF") of evidence, submissions of parties, Board orders and decisions. This Decision with Reasons will be available in ERF form shortly after initial copies are issued in hard form. The ERF version will have the same text and numbered headings as the hard form, but may be formatted differently.

2. THE SETTLEMENT PROPOSAL

2.1 COMMENTS

2.1.1 The Board believes that it would be helpful to the parties to make the following comments on the Settlement Proposal.

2.2 SETTLEMENT PROPOSAL - GENERAL

2.2.1 The Board is pleased that the parties were able to reach an agreement to propose a settlement to the Board on a large number of complex issues. In particular the Board would like to acknowledge the efforts of Gail Morrison, the settlement facilitator. The Board notes that as they did in the settlement of the 2001 Test Year, the parties were able to reach agreement on all of the monetary issues impacting rates for the 2002 Test Year, allowing the Board to issue a final rate order expeditiously.

2.2.2 The Board also recognizes the effort by all the parties in preparing the Settlement Proposal document, including delineating the scope of the issues. The Board appreciates the explanation of the issues, settled and unsettled, given by counsel for ECG at the commencement of the oral hearing.

2.3 TIMING

2.3.1 The Board is concerned about the length of time taken for filing the Settlement Proposal document. The Board notes that this delayed the start of the hearing by a week and contributed to the overall delay in the process.

2.3.2 The Board appreciates that there is a balance between a comprehensive Settlement Proposal document and the need to proceed expeditiously with the oral phase of the proceeding. It would assist the Board if, in future proceedings, the parties provided the Board with a realistic estimate of the time required to finalize the Settlement Proposal document so that an appropriate schedule for the proceeding could be determined.

2.3.3 The Board notes that the financial impact statements relating to the Settlement Proposal were not filed until after the start of the oral hearing. It is essential for the Board to consider and review the financial impact in order to determine whether the Settlement Proposal should be accepted. The Board reminds the parties that the *Settlement Conference Guidelines* anticipate that this material will be filed prior to the commencement of the oral hearing.

2.4 GAS VOLUME BUDGET

2.4.1 In settling Issue 1.1 in the 2001 Settlement Proposal intervenors expressed their concern about ECG's new average use forecasting methodology in general, and the accuracy of the new models in particular, and reserved the right to examine ECG's forecasting model in this proceeding. The 2001 Settlement Proposal required ECG to file evidence in this proceeding on the results the forecasting models would have

generated for Fiscal 2001 using actual data for all driver variables. ECG contended that the results indicate that the average use models are "good objective predictors of average uses and do not exhibit any systematic bias". The intervenors believed that it was too soon to pronounce definitively on whether these models are working well at this point, given the limited experience with ECG's econometric models for forecasting average uses.

2.4.2 The Board notes that although the parties have reached an agreement in the Settlement Proposal on the throughput forecast to be used for setting rates in the 2002 Test Year, the Board makes no determination as to the overall accuracy of the model or whether the model should be accepted as a basis for forecasting throughput in future rates cases.

2.5 UNDERUTILIZATION OF THE LINK PIPELINE

2.5.1 The Board notes that the Settlement Proposal provides that the full costs of underutilization of the Link Pipeline will be to the shareholder's account and that the underutilization amount that was posted to the Purchased Gas Variance Account ("PGVA") will now be eliminated.

2.5.2 The Board expects ECG, when clearing the PGVA, to provide the Board with sufficient evidence to confirm that the underutilization entries have been eliminated in accordance with the agreement reached in the Settlement Proposal.

2.6 RISK MANAGEMENT PROGRAM

2.6.1 As part of the 2001 Settlement Proposal ECG agreed to form a working group to examine the principles that underpin ECG's Risk Management Program. The Board notes that ECG has retained Peyton Feltus of Randolph Risk Management to review ECG's Gas Supply Risk Management Policies and Procedures Manual and has agreed to file the updated manual for examination in ECG's next rates case.

2.7 QUARTERLY RATE ADJUSTMENT MECHANISM ("QRAM")

2.7.1 In the 2001 Settlement Proposal the parties agreed to a new methodology for adjusting the utility gas commodity price during the test year and clearing ECG's PGVA on a quarterly basis.

2.7.2 The QRAM for ECG commenced in the 2002 Test Year, with the first adjustment under the new methodology effective January 1, 2002. The Board reviewed and approved, in the form of interim rate orders, a total of three QRAM applications relating to the 2002 Test Year.

2.7.3 The Board observes that on two occasions during the 2002 Test Year (rate adjustments effective January 1, 2002 and July 1, 2002) the QRAM applications did not strictly comply with the approved methodology. The QRAM methodology is designed so that applications can be dealt with on an expedited, summary basis and the Board is reluctant to agree to ECG's unilateral changes in the methodology without the agreement of the other parties.

2.7.4 The 2001 Settlement Proposal anticipated that:

> The new methodology, including the 0.5¢/m^3 adjustment and clearance thresholds, will be examined thoroughly in the light of the eight principles enumerated earlier in this settlement. This examination will occur in ECG's next rates case following fiscal 2002 or, instead, in a proceeding held for this purpose subsequent to Fiscal 2002. ECG will prepare and file, for this purpose, a report on customer response, customer care costs, and administrative costs. ECG will also prepare and file a consequential recommendation on adjusting or maintaining, as the case may be, the size of the adjustment and clearance thresholds.

2.7.5 At the oral hearing, when dealing with the QRAM adjustment to be effective July 1, 2002, a number of parties commented that minor changes in the QRAM methodology may be desirable.

2.7.6 The Board notes that the Union settlement agreement in the recent RP-2001-0029 proceeding proposed that Union's QRAM methodology be examined in conjunction with ECG's fiscal 2003 rates case or in a generic proceeding held specifically for that purpose. Although the Board would like to see convergence in the QRAM methodologies for ECG and Union, the Board recognizes the two methodologies contain fundamentally different approaches.

2.7.7 The Board expects that the ECG's QRAM review will be dealt with in the fiscal 2003 rate case, if possible.

2.8 COST OF SHORT AND LONG TERM DEBT

2.8.1 The Board is concerned that ECG's credit rating has been downgraded, in part, due to the ratings actions on ECG's ultimate parent, Enbridge Inc. ("EI") and about the impact of the resulting additional costs of debt incurred by the utility. The Board expects ECG to establish the reasonableness of the cost of debt for rate-making purposes attributable to the utility alone, and not as a result of any linkage between ECG's and EI's credit profiles.

2.9 DISTRIBUTION PLANT WORK AND ASSET MANAGEMENT SOLUTION

2.9.1 The Board notes that the DPWAMS issue was not resolved in the Settlement Proposal. The Board has a number of concerns with respect to the DPWAMS project.

2.9.2 First, the Board notes that ECG's pre-filed evidence dealt with the DPWAMS project in a cursory manner and included only a small section on DPWAMS in the IT Capital Budget section although the project cost was estimated initially at $20.5 million over a two-year period.

2.9.3 While this evidence was augmented, to a degree, by interrogatories from Board staff and the intervenors, the Board notes that ECG did not file the supporting business case document, requested by parties in the interrogatories, until April 12, 2002, approximately one week prior to the commencement of the Settlement Conference.

2.9.4 Indeed, ECG had not responded to all of the interrogatories prior to the Settlement Conference and the Settlement Proposal indicated:

> ECG is prepared to respond to interrogatories from the other parties. ECG will use its best efforts to file responses to these interrogatories prior to the commencement of the Board's oral hearing.

2.9.5 On the first day of the oral hearing, ECG advised the Board that it would not be filing the responses to interrogatories nor updating its evidence on DPWAMS, including cost estimates, for several days.

2.9.6 While a number of intervenors acknowledged that ECG had made efforts to answer the interrogatories, the Board is very concerned that ECG did not provide the Board and the intervenors with all of the relevant information concerning DPWAMS on a timely basis. The Board realizes that some decisions, of necessity, must be made quickly and based on less than perfect information, however, this is not one of them.

2.9.7 At the oral hearing ECG further amended its Application and evidence to reflect that ECG had revised its schedule for the DPWAMS project and that it was no longer seeking approval to close any portion of the DPWAMS project to rate base in the 2002 Test Year. Consequently the DPWAMS project would have no impact on rates for the 2002 Test Year. However, ECG advised the Board that before it was prepared to proceed with the DPWAMS project, the Company required a "degree of confidence" that the costs of the project would be recovered from ratepayers.

2.9.8 Accordingly, at the oral hearing ECG advised that it was requesting the following decisions from the Board:

- approval in principle of the DPWAMS project;
- an indication that the reasonable costs of the project would be recovered from ratepayers under whatever rate methodology is used for rate setting purposes in the period in question provided that the project is demonstrated to be complete and fully functional; and
- acceptance of the $6.0 million of DPWAMS capital expenditure costs for the Test Year.

2.9.9 The approval in principle would comprise:

- agreement that a distribution plant work and asset management solution is required;
- agreement that the solution proposed by the Company would deliver the required functionality; and
- agreement that the costs of the Project, as currently forecast, are reasonable.

2.9.10 ECG claimed that the DPWAMS project was required to "maintain, not to enhance but to maintain, levels of productivity" and that without the project "service levels will deteriorate and costs will increase ... In other words DPWAMS is not discretionary".

2.9.11 However, in ECG's answer to a CAC interrogatory, ECG advised that senior management had not yet approved the implementation of the DPWAMS project. ECG argued that Company management "has complete confidence in the project and that was demonstrated when it approved the business case and gave us the green light to continue seeking the approvals that we require in this proceeding".

2.9.12 The Board notes that at the time of the oral hearing the Company's management had not given approval to the implementation of the DPWAMS project.

2.9.13 ECG advised that if the Board did not grant the requested relief, ECG would probably not spend money on the DPWAMS project and would see what other possible solutions there might be at less shareholder risk. At the time of the oral hearing, ECG had not investigated alternative solutions.

2.9.14 This approach is unacceptable to the Board. Prospective rate-making requires that the utility must advise the Board of its intended actions and forecasted costs in advance of the test year. The plans must be real and not hypothetical and management must be committed to implementing these plans. The Board is not prepared to scrutinize a project and "pre-approve" a project before the Company's management is committed to it.

2.9.15 Regulatory principles dictate that costs reasonably incurred to produce something that is used and useful are recoverable from ratepayers in rates. The onus remains on the utility to establish that expenditures have met this standard.

2.10 PBR O&M

2.10.1 The Board notes that in the EBRO 497-01 Decision, dated April 22, 1999, approving the Company's targeted performance-based regulation plan for operations and maintenance expenses ("TPBR"), the Board stated at paragraph 3.0.5:

> The Board also accepts the three year term of the plan, with the expectation that the Company will have developed, in

> consultation with stakeholders, and be ready to implement, an appropriate comprehensive PBR plan at the end of this term.

2.10.2 The Board notes that the 2002 Test Year is the last year of the TPBR. The Board understands that the Company has applied for a cost of service approach for ECG's 2003 fiscal year, as a basis for an incentive regulation plan.

2.10.3 The Board is also aware that there are ongoing discussions with the stakeholders group regarding the development of an appropriate incentive regulation structure. The Board encourages the parties to continue with their consultations in an effort to reach an agreement on a proposed structure.

2.10.4 The Board is concerned that timing may simply not permit an appropriate review and subsequent Board decision in time to implement an incentive regulation scheme prior to the start of the ECG's 2004 fiscal year. The Board cautions the parties that it may be reluctant to proceed with what would amount to a "retroactive" incentive regulation plan, as such a plan would not only be an oxymoron but appears to be counter-intuitive to the theory of incentive regulation.

2.11 DEMAND SIDE MANAGEMENT

2.11.1 In its comments on the 2001 Settlement Proposal, the Board stated:

> The Board shares the concern expressed by customer-oriented parties about the overall rate at which the Demand Side Management ("DSM") costs are increasing relative to gas savings, the consequential impact on rates, and the extent to which ECG needs incentives to further control costs in this area. The parties' agreement to determine the budget and the pivot point in advance of the test year is a good first step.

2.11.2 During Issues Day in this proceeding, responding to concerns raised by CME, the Board indicated that while there is a need to review the underlying design principles in the Company's DSM plan, the question is when and how. The Board noted that the Company was committed to completing its review and submitting a DSM plan that is compatible with comprehensive performance based regulation in the first or second quarter of calendar 2002. As a result, the Board determined at Issues Day that it would be premature to conduct a DSM review during this proceeding.

2.11.3 The Board notes that Issue 8.3 of the Settlement Proposal dealing with clearance of balances recorded in the 2000 Shared Savings Mechanism Variance Account ("2000 SSMVA") and the 2000 Lost Revenue Adjustment Mechanism ("2000 LRAM") envisages that, after delivery of the final audit report, ECG will finalize the amounts to be recorded in the 2000 SSMVA and the 2000 LRAM by July 31, 2002. A settlement conference for this issue will be convened following the delivery of the position papers by the other parties, and resolved and unresolved issues will be presented to the Board in the proceeding established to examine ECG's rates application for Fiscal 2003, or earlier, if the schedule permits.

2.11.4 The Board realizes the importance of the DSM issue and the fact that these issues relate to clearance of 2000 accounts. Accordingly the Board has issued a procedural order establishing a settlement conference to deal with these issues commencing December 3, 2002.

2.12 DEFERRED TAXES

2.12.1 The Board notes that as part of the Settlement Proposal, ECG and the other parties requested that the Board deal with deferred taxes issues (Issues 10.1,10.2 and 10.3) in a separate phase of this proceeding or a separate proceeding. In accepting the Settlement Proposal, the Board indicated that it would be issuing a procedural order to establish a separate proceeding for dealing with the deferred taxes issues, in due course. The Board understands that the parties have been meeting with Board staff in an attempt to narrow the issues to be determined by the Board.

2.13 DEFERRAL AND VARIANCE ACCOUNTS

2.13.1 The Board once again is generally concerned with the proliferation of deferral and variance accounts. In particular the Board is concerned with the establishment of the Unaccounted For Gas Variance Account for the 2002 Test Year ("2002 UAFVA") to record variances between forecast and actual unaccounted for ("UAF") gas. While the Board notes that this account has been established on a "trial basis" the Board is concerned that ECG must establish valid reasons as to why the forecast error remains high and is a risk that should be mitigated by the creation of a variance account.

2.14 RETROACTIVITY

2.14.1 The Board continues to have concerns about the retroactive application of rates. The proposal outlined in section12.3 of the Settlement Proposal for the Board to "assist ECG in getting back on track, as it were, by issuing a partial, and then final, Decision with Reasons" is not a long term solution to this problem.

2.14.2 In particular, the Board is concerned with timing and delays in this rates proceeding. The Application was filed only days before the beginning of the 2002 Test Year. The initial evidence was incomplete and significant pieces of the Company's pre-filed evidence were filed well after the initial filing of September 25, 2001. Missed deadlines, incomplete evidence, lack of full disclosure, delays in answering the interrogatories, and unsolicited evidence updates requiring additional rounds of interrogatories all contributed to the length of time for the process. ECG is now approximately nine months behind where it should be for a typical prospective test year rate case.

2.14.3 The Board is not convinced that ECG is making sufficient efforts to "get back on track" and is concerned that ECG may not be dedicating sufficient resources to the regulatory process.

2.14.4 The Board expects ECG to develop, in consultation with Board Staff and the intervenors, a realistic plan for future applications to "get back on track" and avoid retroactivity.

3. ALLIANCE AND VECTOR

3.1 BACKGROUND

The Alliance Pipeline Project

3.1.1 Alliance Pipeline Limited Partnership and Alliance Pipeline L.P. (together "Alliance") announced its pipeline project on June 10, 1996. The project involved a large scale natural gas pipeline extending from northeastern British Columbia and northwestern Alberta to Joliet in the vicinity of Chicago, Illinois ("Chicago"). The pipeline provided western Canadian gas producers with greater exit capacity from producing regions in northeast British Columbia and parts of Alberta and direct access to the major gas markets of the midwest region of the United States. EI was one of the 18 original sponsors of the Alliance pipeline and initially held a 10.9% ownership interest.

3.1.2 ECG advised the Board that the purpose of the Alliance pipeline was to provide an alternative to the existing TransCanada Pipelines Ltd. ("TCPL") pipeline which had insufficient capacity at the time to serve market growth projections and served as a limit on the extent to which western Canadian producers could supply that market growth.

3.1.3 Alliance received regulatory approval from the U.S. Federal Energy Regulatory Commission ("FERC"), in the form of a Certificate of Public Convenience and Necessity, on September 17, 1998. Similar regulatory approval was received from the Canada's National Energy Board ("NEB") on November 26, 1998.

3.1.4 About the same time as Alliance was announced, there were a number of competing proposals, including TCPL's NEXUS project and the Northern Border project which, if approved and built, would also improve exit capacity and provide additional access to the U.S. Midwest markets.

3.1.5 ECG made its first formal commitment to the Alliance project in November 1996. At the time ECG made this commitment, it had not yet made firm arrangements to complete the physical delivery of the Alliance-delivered gas from Chicago to ECG's storage pools near Dawn, Ontario.

3.1.6 In the summer of 1996 however, ECG had begun discussions with parties about moving gas from Chicago to Dawn. ECG's most promising transportation route, at the time, was the path proposed by ANR Pipeline Company ("ANR") comprising ANR's system, expanded as required, and the Link pipelines with Michigan Consolidated Gas Company ("MichCon") as the intermediate transporter between the two.

3.1.7 With the withdrawal of ANR in February 1997, the ANR/MichCon/Link pipelines were not going to be built as planned. This meant that ECG was required to find another physical route to connect the gas delivered to Chicago by the Alliance pipeline to its storage pools near Dawn.

The Vector Pipeline Project

3.1.8 On June 27, 1997, Vector Pipeline L. P. and Vector Pipeline Limited Partnership (together "Vector") announced the Vector project, a new international pipeline project that would provide natural gas transportation service between the large market hub located at Chicago, Illinois and the existing hub located at Dawn. Gas transported on Vector could be purchased either at the Chicago hub or further upstream from a number of American and western Canadian supply basins.

3.1.9 TriState was a pipeline proposal in competition with Vector at the time. TriState filed its application with the FERC on November 9, 1998 and with the NEB on December 23, 1998. With the withdrawal of TriState's applications in January 2000, Vector became the only physical route from Chicago to Dawn.

3.1.10 ECG made its first formal commitment to the Vector project on June 1, 1999 and a subsequent commitment for transportation capacity was made to Vector on December 22, 1999.

3.1.11 ECG's first Vector commitment was designed to accommodate it's Firm Transportation ("FT") and Authorized Overrun Service ("AOS") entitlements with Alliance when the "rich gas" is converted to energy units. ECG described its Alliance commitments and the first commitment to Vector as a "matched pair" that created a single transportation path for ECG from western Canada to Dawn.

3.2 THE ISSUE

3.2.1 This issue in this proceeding concerns the prudence of ECG's decisions to enter into long term transportation arrangements with Alliance and Vector, including a review of the associated cost consequences of these arrangements.

3.2.2 There were four specific decisions made by ECG at issue in this proceeding:

- in November 1996 ECG's decision to enter into precedent agreements with Alliance, for a term of 15 years once all contractual conditions were satisfied, to acquire Firm Transportation ("FT") service from Alliance for a daily volume of 1,415.4 10^3m^3/d and 50.0MMcf/d, plus authorized overrun service ("AOS") respectively in Canada and United States ("Alliance 1");

- in November 1997 ECG's decision to increase its commitment to Alliance by 708.2 10^3m^3/d and 25.0 MMcf/d to 2,124.6 10^3m^3/d and 75.0 Mmcf/d,of FT Service plus AOS ,respectively in Canada and United States by accepting an assignment of this capacity from Alberta Energy Company Ltd. ("AEC") at the same time as EI acquired an additional ownership interest of 8.036% in Alliance from AEC ("Alliance 2");

- ECG's decision, in June 1999 to acquire FT service from Vector for 96,000 Dth/d and 101,295 GJ/d, respectively in the United States and Canada ("Vector 1"); and

- ECG's decision, in December 1999 to acquire a second tranche of FT service from Vector for 79,000 Dth/d and 83,360 GJ/d, respectively, in the United States and Canada ("Vector 2").

3.2.3 The prudence of ECG's actions in entering into these long term transportation arrangements was challenged by several of the intervenors. CAC, CME and VECC each took a position challenging the prudence of ECG's decision, Union supported ECG, IGUA took no position, and CEED, HVAC and Schools were silent on this issue.

2001 Settlement Proposal

3.2.4 This issue arose in this proceeding as part of the 2001 Settlement Proposal. Intervenors were concerned about the cost consequences of ECG's new transportation path for gas sourced in western Canada relative to those of ECG's traditional transportation path (on TCPL's Canadian Mainline from Empress to, for comparative purposes, ECG's delivery points in TCPL's Central Delivery Area ("CDA") including Parkway).

3.2.5 ECG and the intervenors agreed in the 2001 Settlement Proposal that an examination of this issue would be facilitated by quantifying, during the 2001 Test Year, the cost differential between the two transportation paths by means of a notional deferral account (the "Notional Deferral Account"). The parties agreed that the entries in this

Notional Deferral Account, together with the other information ECG provided, would form an evidentiary basis for examining whether the entire cost differential should be allowed for ratemaking purposes and, if not, the amount that should be disallowed. ECG and the intervenors agreed in the 2001 Settlement Proposal that any such disallowance would not be retroactive, however, but rather any amount disallowed would be applied prospectively as a credit to ECG's revenue requirement for the 2002 Test Year.

3.2.6 The 2001 Settlement Agreement provided that any party could challenge the cost consequences of the new transportation path, in this proceeding or thereafter, on any grounds including, without limitation, the prudence of management actions that gave rise to such gas cost consequences by reference, for example, to the delivered cost of gas via the new transportation path relative to market area prices.

3.2.7 In this proceeding, ECG filed evidence showing the amounts in the Notional Deferral Account and a written account of the events surrounding the Alliance and Vector transportation arrangements. The Notional Deferral Account showed that the transportation cost differential for the 10 month period from December 1, 2000 (the in-service date) to September 30, 2001, was $12.4 million in favour of the traditional path via TCPL.

3.2.8 ECG noted that the Notional Deferral Account recorded a “hypothetical” cost differential and suggested that there should two adjustments to this amount: namely a commodity price adjustment and a TCPL tolls adjustment.

3.2.9 ECG suggested a commodity price adjustment of $11 million, as a "means of normalizing the abnormally high commodity cost of gas for the new path in December 2000". ECG advised the Board that this cost was abnormally high because for this month "ECG's suppliers insisted on spot -- daily -- pricing rather than monthly pricing".

3.2.10 ECG also suggested another adjustment to reflect TCPL's final tolls for the 10-month period rather than ECG's forecast of them. ECG suggested that the adjustment should be $0.57 million in favour of the traditional path, rather than $3.33 million in favour of the new path.

3.3 REVIEW OF PRUDENCE

3.3.1 In a prudence review, ECG suggested the following guidelines, based on a study prepared by the National Regulatory Research Institute ("NRRI").

- A utility's decision should be presumed to be prudent.
- A prudence review should consider what a reasonable person would have done in the similar circumstances.
- A prudence review should take into account the information available to managers when the regulated firm made the decision in question.
- Prudence is determined by using factual information. Evidence must include facts, not merely opinion, about the elements that went into the decision.

3.3.2 ECG submitted that the test for prudence, in practice, is the "reasonable person" test. Would a reasonable person consider that a utility's management decision was formed by good judgment based on facts and premises that management knew or ought to have known? A reasonable person would have regard to prevailing industry practices in existence at the time the decision was taken.

3.3.3 ECG argued that a regulator's decision on the prudence of a utility's management is, "by its nature, a once and for all decision". A utility's management cannot be found to have acted prudently in making a decision in one proceeding and prudently in making the same decision in another proceeding.

3.3.4 ECG submitted that a regulator's decision that a utilities management was prudent is not a "blank cheque" in effect for the future. Utility's have an ongoing responsibility to provide a "best cost" service, which means "utilities will provide safe and reliable services at the lowest reasonable costs".

3.3.5 Union agreed that the Board should apply the four-part test established by the NRRI for determining the prudence of utility management's business decisions.

3.3.6 CAC submitted that a determination of the issue of the prudence of a decision requires that the Board determine the following sub-issues:

- What is the test of prudence?
- Who bears the onus of establishing prudence or the absence thereof?
- What evidence is required to demonstrate prudence?
- If the Board were to determine that ECG was not prudent, what amount should it be entitled to recover with respect to its supply arrangements? To

put the matter another way, what is the monetary measure of a finding that ECG was not prudent?

- What implications, if any, would a finding that ECG had not been prudent have beyond the test year?

3.3.7 CAC submitted that the test of prudence has been drawn from a number of authorities in the United States, which provide that the test should have the following components:

- There is a presumption that the investment decisions of utilities are prudent;
- The presumption of prudence can be overcome by an allegation of imprudence that is backed up by substantive evidence creating a serious doubt about the prudence of the investment decision;
- To be prudent, a utility decision must have been reasonable under the circumstances that were known or could have been known at the time the decision was made;
- The regulator should not use hindsight in determining prudence and it unwise for a regulator to supplement the reasonableness standard for prudence with other standards that look at the final outcome of a utility's decision, although consideration of outcome may have legitimately been used to overcome the presumption of prudence;
- Prudence must be determined in a retrospective factual inquiry. The evidence needs to be retrospective in that it must be concerned about the time at which the decision was made. Testimony must present facts, not merely opinion, about the elements that did or could have been entered into the decision at the time.

3.3.8 CAC submitted that, in restating the test of prudence, the Board should underscore ECG's obligation to keep detailed records of the decision-making process, indicating what factors were considered, and by whom those factors were considered, and setting out the rationale for each decision.

3.3.9 CAC submitted that the evidence in this case on the Alliance/Vector issue suggests that it is both necessary and appropriate to re-state the test of prudence.

3.3.10 The original rationale for the so-called presumption of prudence, as expressed in the US authorities, was that the presumption would allow a utility the freedom to make decisions that were in the interests of ratepayers without undue constraint arising from the fear of regulatory oversight. CAC submitted that it is clear, on the evidence, the value of the presumption must be weighed against the fact that the operation of the presumption may have a significant detrimental effect.

3.3.11 CAC acknowledged that some form of presumption of prudence allows a utility to make small investments without having the positive burden of showing that each one was prudent. Balanced against that, however, is the danger, evident in this case, that the presumption will operate as a screen, allowing a utility to make significant decisions without regard to the best interests of ratepayers, evident conflicts of interest, and the obligation to consider all reasonable alternatives.

3.3.12 CAC submitted that the presumption of prudence should be eliminated, at least in the case of decisions that may have rate-making implications above some threshold of materiality. Where the presumption is eliminated, the Board should require ECG to satisfy it that it considered all reasonable alternatives in order to arrive at a decision that was in the best interests of ratepayers.

3.3.13 CAC argued that the existing formulation of the test, which allows the presumption of prudence to be dislodged where there is evidence of a conflict of interest or where the outcome is clearly disadvantageous to ratepayers, provides insufficient protection to ratepayers who wish to examine the prudence of ECG's decisions. That argument ignores the significant problems which ratepayers have in showing the existence of a conflict of interest, for example. Under existing rules, a utility can hide crucial evidence, or simply deny its existence, and do so with reasonable confidence that it will neither be caught nor sanctioned.

3.3.14 CAC acknowledged a legitimate concern with the use of hindsight. CAC further acknowledged that the prudence of a decision should not be assessed solely on the basis of the outcome of the decision. However, exercising caution in the use of hindsight, and eliminating the presumption of prudence, would still allow ECG considerable freedom to demonstrate that it appropriately considered all of the relevant factors at the time the decision was made.

3.3.15 VECC had no fundamental disagreement with ECG's description of the test for prudence and did not dispute that the focus of the review should be on the circumstances that existed at the time that the impugned decision was made. In VECC's view, however, these circumstances must include a review of the reasonableness of the utility's expectations of future developments and of the future state of the market at the time that the relevant decisions were made.

3.3.16 VECC argued that this approach does not involve the use of hindsight; rather it is the recognition that utility decisions must be prudent, not just for circumstances that are contemporaneous with the decision, but also for future circumstances that could be anticipated at that time the decision was made.

3.4 OVERCOMING THE PRESUMPTION OF PRUDENCE

3.4.1 ECG argued that since it had agreed that the issue of the prudence of these decisions was open to any party to raise, it was not necessary for the Board to make a determination on whether the presumption of prudence was overcome in this case.

3.4.2 The intervenors put forward two bases on which it argued that the Board should find that the presumption of prudence had been overcome:

- there was a conflict of interest between EI and ECG; and,
- the outcome of the decisions to contract for capacity on the Alliance and Vector pipelines dislodged the presumption of prudence.

Conflict of Interest

3.4.3 Dr. Foster, ECG's expert witness, agreed that if there were evidence that a decision to make an investment were influenced by a conflict of interest, that would overcome the presumption of prudence. However, he did not see a conflict on interest in this case. ECG and EI "have pretty much the same interests, the LDC has the requirement to have long-term firm capacity delivered to their system, and the parent owns a portion of that pipeline".

3.4.4 Although ECG has never denied that EI made suggestions in favour of both Alliance and Vector, ECG strongly denied any suggestion that EI used its parental role to dictate ECG's decisions on Alliance and Vector.

3.4.5 CAC argued that since ECG's decision to contract for capacity on the Alliance and Vector pipelines conferred a benefit on EI by virtue of EI's ownership interests in Alliance and Vector this meant that ECG had a conflict of interest in deciding whether to contract for this capacity. While ECG has an obligation to its ratepayers to enter into contracts that benefit those ratepayers, ECG's decision to contract for capacity on Alliance and Vector would confer a benefit on EI, but might not benefit ratepayers. A decision to contract for Alliance and Vector capacity should not, in CAC's submission, benefit EI at the expense of ECG's ratepayers.

3.4.6 CAC stated that there is no evidence that ECG considered the conflict of interest it faced except to the extent that the concept of conflict of interest may a consideration of whether Board approval is required under the Undertakings.

3.4.7 Similarly, CME had problems with ECG's request that the Board find that there was no conflict of interest with respect to EI, favouring Alliance and Vector, and that ECG should be allowed to rely on the "presumption of prudence". ECG is effectively requesting the Board to give it the benefit of the doubt. CME was also concerned that ECG has not maintained adequate written records that would assist intervenors and the Board in assessing this matter after the fact.

3.4.8 CME submitted that ECG should not be allowed, under the circumstances, to rely on the presumption of prudence. EI made an investment in Alliance and EI received a benefit through Alliance. CME argued that a conflict of interest arises since ECG conferred a benefit on EI, by contracting for capacity on the Alliance gas pipeline since it helped EI obtain regulatory approval for the pipeline.

Outcome of the Decision

3.4.9 CAC argued that the amount recorded in the Notional Deferral Account shows that, in both the ten-month period and the 2001 Test Year, the TCPL route was cheaper than the Alliance/Vector routes, even factoring in the effect of the recent, NEB-approved, TCPL toll increase. Accordingly, CAC argued that the presumption of prudence has been overcome.

3.4.10 ECG argued that any consideration of the outcome of the decisions necessarily involved the use of hindsight and therefore should not be a consideration of the Board.

3.5 PRUDENCE OF ECG'S DECISIONS

3.5.1 In CAC's submission, since the presumption of prudence is dislodged, the onus then shifts to ECG to establish that the decisions to contract for Alliance and Vector capacity were prudent.

3.5.2 CAC stated that the second component of the test of prudence is the determination of the time period during which the decisions were made, and, therefore, the time period within which prudence must be assessed.

3.5.3 Since there were separate decisions for each of the Alliance and Vector contracts, and since the decisions were made at different times, CAC submitted that they should be considered separately.

3.6 ALLIANCE 1

Company's Position

3.6.1 ECG's evidence is that its decision to enter into the Alliance 1 contract was made in the period from approximately June of 1996 to November of 1996 and that is the appropriate time period for purposes of assessing prudence.

3.6.2 ECG submitted that it made its commitment to Alliance for the following reasons:

- ECG required incremental transportation to serve market growth in its franchise areas;
- ECG's comparative analysis of Alliance and TCPL, after giving effect to NEXUS and other TCPL-related projects, favoured Alliance on the basis of the information available at the time;
- Alliance would comprise the major segment of an alternative transportation path for gas sourced by EGC in western Canada; and
- Alliance's capacity could be expanded by compression, rather than pipe, so that expansion capacity would be cheaper to install on a unit basis than the original capacity.

3.6.3 ECG advised the Board that prior to contracting for capacity on Alliance, a comparative analysis of Alliance and TCPL was prepared. This analysis was synthesized in an internal memorandum dated October 25, 1996 from Juri Otsason, a member of ECG's Gas Supply Department, to Rudy Riedl, then Senior Vice President, Strategic Planning and Gas Supply of ECG and Janet Holder ("Otsason Memo"). The Otsason Memo was the centrepiece of the evidence offered by ECG in support of its decision to contract on Alliance.

3.6.4 At the hearing ECG also provided the Board with a number of other miscellaneous documents, including internal memos, options and risks assessments, and rudimentary financial analysis spreadsheets. ECG argued that these documents supported all of the factors identified in the Otsason Memo.

3.6.5 The Otsason Memo described the "pros" and "cons" of the two options identified as the traditional NOVA/TCPL route as its system would have been after expanding by 2.3 Bcf/d for the NEXUS project and the Alliance/ANR/Union/TCPL route to ECG's CDA, southern Ontario, in 2000. Other options such as purchasing gas on the Chicago market or using the Northern Border pipeline were not analysed at that time.

3.6.6 The "pros" of the Alliance route outlined in the Otsason Memo were as follows:

- The Alliance route was estimated to cost 5¢/GJ more than the TCPL route, although the range of cost differentials was from 23¢/GJ higher to 12¢/GJ lower;
- Alliance would provide competition to NOVA/TCPL, and would reduce the rate of expansion of TCPL and the rate of escalation of its tolls, although these would happen whether or not ECG contracted on Alliance;
- Alliance would allow ECG to diversify its transportation portfolio;
- By passing through an area such as Chicago with an active gas market, Alliance would enhance ECG's ability to provide transactional services and take advantage of arbitrage;
- ECG would be able to utilize its entitlement on the Link Pipeline;
- Alliance would enhance the prospects of third parties contacting for capacity on the Link Pipeline;

- Reduced risks of exposure to increased TCPL tolls; and
- An alternate supply route enhances physical security of supply.

3.6.7 The Otsason Memo also identified the following "cons" of the Alliance pipeline:

- Alliance involved a long term commitment at a time of uncertainty of future role for ECG regarding upstream capacity;
- Alliance had considerably higher risks of adverse regulatory treatment, in-service delays and cost overruns;
- Alliance increased reliance on Union for M12 transportation;
- Acquisition of gas supply for Alliance was more complex;
- The Alliance route was operationally and administratively more complex; and
- Alliance created potential complexities for direct purchase.

3.6.8 The Otsason Memo also pointed out that ECG contracting on Alliance would enhance the probability of the Alliance pipeline being built. The Otsason Memo made a recommendation in favour of Alliance instead of TCPL.

3.6.9 The Otsason Memo quantified the financial risks in broad terms and described the assumptions made about some of them. For example, it assumed that exchange rates for the U.S. and Canadian dollar would change in favour of the Canadian dollar.

3.6.10 ECG argued that the comparative analysis in the Otsason Memo also demonstrated that ECG not only looked at the "cons" as well as the "pros" of Alliance, but also the range of possible outcomes in the light of various assumptions for both Alliance and TCPL.

3.6.11 Ms. Holder testified at the hearing that the Otsason Memo "was never intended to capture everything that was already known by Mr. Riedl and myself at the time" "We were very knowledgeable people or individuals in this business at the time; that was Mr. Riedl's life and my life as well as Mr. Otsason's. So there were many discussions that went along with those memos." Mr. Riedl, in turn, passed on the Otsason Memo to Mr. R.D. Munkley who was ECG's President at the time.

3.6.12 The precedent agreements with Alliance were signed in November 1996 by Mr. Riedl and John Aiken, another Senior Vice President, on behalf of ECG. ECG advised the Board that together they had the authority to execute, without approval by ECG's board of directors, agreements for the transportation of natural gas with an annual value of up to $30.0 million. At the time, the annual value of ECG's initial commitment to Alliance was $18.3 million.

Intervenors' Positions

3.6.13 CAC, using the criteria in the *New England Power Company* case, contended that the relevant time periods in which to consider the Alliance contracts was either the six month period in 1996 when the decision was made or the period at the beginning of 2000 when the gas began to move on the Alliance pipeline, and ECG was thus obligated to pay.

3.6.14 CAC argued that its expert witness, Mr. Stauft, suggested that in 1996 there were at least four alternatives, reflecting developments that had occurred or were likely to occur before gas actually had to move, in 1999, that ECG knew about or should have known about.

Chicago Market

3.6.15 CAC took issue with ECG's suggestion that the development of Chicago as a market alternative would not have been known to them. CAC submitted, however, that the evidence suggests that, even within that narrow time frame, that was not the case. The expansion of the Northern Border pipeline, and the building of the Alliance pipeline itself, were going to add approximately 2.7 Bcf to the Chicago market from the Alberta supply basin alone. CAC submitted that the addition of this additional capacity could reasonably have been predicted to have an effect, whether on Alberta prices or the development of Chicago as a market, or both.

3.6.16 CAC pointed out that ECG's evidence, under cross-examination, was that it did not consider Chicago as an alternative supply source because it was not ECG's practice to contract back to a supply hub but rather to contract for long-term transportation back to the supply basin.

3.6.17 CAC took issue with Dr. Foster's assertion that, in 1996, Chicago was not a well-developed, functioning market centre. CAC said that assertion would be relevant only if the decision to contract for Alliance capacity either had to be made in 1996, which it didn't, or if the planning horizon for the decision to contract for capacity was limited to six months in 1996, which it wasn't.

3.6.18 Dr. Foster conceded, in cross-examination, that, in making its decision, ECG should have considered factors that might affect the contract over its 15-year term, which would seem, reasonably, should have included the development of the Chicago market in the nearly three years before the Alliance pipeline was scheduled to be completed.

3.6.19 CAC pointed out that ECG itself did eventually consider Chicago as a viable market as noted in the May 31, 1999 memo from Mr. G. Dann of ECG's Gas Supply Department ("Dann Memo").

Timing of the Decision

3.6.20 CAC expressed doubts about Dr. Foster's assertions concerning the alleged benefits of the Alliance/Vector contracts. He asserted, for example, that ECG needed gas in 1996, leaving the impression that ECG had to contract for Alliance capacity in 1996. In fact, ECG contracted for Alliance capacity in 1996 when, at the earliest, it would be available in late 1999, and at a time when it had no way of getting the Alliance gas from Chicago to Ontario.

3.6.21 Further, CAC pointed out that ECG's own expert, Dr. Foster, conceded that the development of the Chicago market was a predictable outcome of the expansion of the Northern Border pipeline and the building of the Alliance pipeline.

3.6.22 During the oral phase of the hearing ECG's witnesses strongly asserted that the ECG's participation was not required at the time that ECG contracted for capacity in order for the Alliance pipelines to be constructed.

Lack of Physical Route from Chicago to Dawn

3.6.23 CAC argued that there is no evidence that ECG was under any pressure to enter into a supply arrangement by the Fall of 1996. The evidence that TCPL capacity would not have been available by the Fall of 1999 is, at best, ambiguous. At worst, however, there was no greater uncertainty about the availability of TCPL capacity

than there was about the completion of the Alliance pipeline on time. In addition, the evidence is that when the first Alliance contract was signed, there were no arrangements in place, or indeed even any arrangements on the horizon, by which ECG could get the gas from Chicago into Ontario.

Diversifying Supply

3.6.24 With respect to achieving the objective of diversifying supply, CAC stated that contracting for supply in the Chicago market would have accomplished that goal. Since TCPL and Alliance have essentially the same supply basin, contracting for capacity in the Chicago would have accomplished the goal of diversifying supply more readily than would have contracting for capacity on Alliance.

3.6.25 With respect to the objective of putting competitive pressure on TCPL, CAC suggested that this would have been accomplished merely by building the Alliance pipeline. ECG's own witnesses conceded that it was not necessary for ECG to contract for capacity on the Alliance pipeline in order to achieve that objective. In addition, competitive pressure would have been placed on TCPL by using the Chicago market as a source of supply.

3.6.26 CAC submitted that it is important to remember that ECG had conducted no studies or analyses to support its belief that its contracting for capacity on Alliance would cause TCPL rates to drop. ECG conducted no study or analysis to suggest that even if TCPL rates did drop, they would offset what ECG staff recognized would be the higher cost on the Alliance system.

Security of Supply

3.6.27 ECG stated that it examined alternatives to Alliance and Vector from a long term perspective and also "in light of a public utility's duty to provide security of supply – delivery as well as commodity – for its franchise areas on a long term basis". ECG advised the Board that its "preferred means of delivery in 1996, and for the foreseeable future at the time, was upstream pipeline capacity extending all the way back to supply basins."

3.6.28 With respect to security of supply, CAC relied on Mr. Stauft's testimony that "from the perspective of 1996, in particular, Chicago should have been seen as at least as good an option and likely a far better option for purposes of acquiring supply on a reliable basis.... at that time, it was pretty clear that the Northern Border pipeline extension -- expansion/extension project would go ahead, and ECG was clearly assuming that the Alliance project would go ahead; otherwise, they wouldn't be analysing the economics of doing that. Given all of that, and those two projects together represented about 2.7 Bcf a day of new incremental supply into the Chicago area, I think the only reasonable conclusion at that time would have been that that additional supply would have made Chicago fine as a supply source".

3.6.29 Mr. Stauft also pointed out that the supply market available to Alliance shippers is limited and consists of approximately 30-odd gas plants in Alberta plus some interconnects with the ATCO system. Mr. Stauft indicated that directionally, it "wouldn't be fair to say that Chicago was worse, from a security of supply perspective, than Alliance, even in 1996".

3.6.30 CAC questioned whether there were any factors at work, in 1996, that required ECG to contract for capacity on Alliance rather than allowing the Chicago market to develop.

3.7 ALLIANCE 2

Company's Position

3.7.1 ECG stated that it increased its commitment to Alliance by 708.2 $10^3m^3/d$ in Canada and 25.0 Mmcf/d in the Untied States in November 1997, by means of an assignment of capacity from the Alberta Energy Company Ltd. ("AEC"). This occurred at the same time as EI acquired an additional ownership interest of 8.036% in Alliance from AEC.

3.7.2 ECG stated that it was willing to accept the assignment from AEC because, at the time, ECG's updated forecast of market growth indicated that ECG would require more than the assigned volume for the 2000-01 gas year and beyond. ECG noted that its updated forecast of market growth formed part of ECG's written evidence for the hearing, before the NEB, of Alliance's Canadian facilities application (NEB file GH-3-97).

3.7.3 ECG argued that its opportunity to acquire this additional capacity with Alliance arose between TCPL's applications for its 1998-99 (GH-2-97) and its 1999-2000 (GH-3-98) expansion programs (J3.5/J3.6) and for this reason, acquiring additional capacity on TCPL was not an alternative at the time.

3.7.4 ECG's evidence was that the opportunity to increase its commitment on Alliance also arose after EI had announced the Vector project and TCPL and two other sponsors joined EI in the Vector project. As ECG pointed out, given the timing of the Vector announcement in June 1997, there was the prospect of a transportation path to move the increased volume from Chicago to Dawn at the time of signing Alliance 2 in November 1997.

Intervenors' Positions

3.7.5 CAC submitted that ECG's evidence does not establish that its initial decision to contract for Alliance capacity was a prudent one, even on its own chosen criteria. Beyond that, CAC submitted that there is no better or different evidence in support of its decision to contract for the second tranche of Alliance capacity.

3.7.6 The other Intervenors raised no additional concerns with respect to Alliance 2, but relied on their general concerns with respect to the Alliance project.

Company Reply

3.7.7 ECG countered intervenors with the argument that Chicago became a well-developed functioning market only when the Northern Border expansion/extension and thereafter Alliance became operational.

3.7.8 Dr. Foster's opinion was that ECG acted prudently when deciding to make commitments to Alliance and Vector.

3.7.9 ECG argued that it is the utility's commitment and the circumstances at the time, rather than the utility's subsequent compliance with the commitment by incurring costs, that should be the focus of a prudence review.

3.7.10 ECG argued that when considering likely future circumstances, a reasonable person would have regard to prevailing industry practices at the time; for example, the prevailing practice of an Ontario utility contracting for long-term transportation back to the supply basins.

3.8 VECTOR 1

Company's Position

3.8.1 ECG did not make a commitment to Vector 1 until June 1, 1999, when it signed precedent agreements for a term of 15 year once all the contractual conditions were satisfied. The 15-year term would commence on Vector's in-service date which, at the time, was expected to be November 2000.

3.8.2 ECG stated that it sized Vector 1 to accommodated ECG's FT and AOS entitlements with Alliance, post 1997, when "rich gas" is converted to energy units. According to ECG, Alliance and Vector 1 are a "matched pair" and, as such, comprise a single transportation path for ECG from western Canada to Dawn.

3.8.3 ECG stated that it examined not only physical transportation alternatives, but also Chicago-to-Dawn gas swaps, before committing to Vector 1. ECG submitted that it looked at the "cons" as well as the "pros" and selected Vector 1 - the cheapest route instead of swaps because:

- "it was uncertain as to whether [gas marketers] would be able to do the total volume" but, even if so, "the Dawn basis would likely increase because Dawn is thinly traded"; and
- "the potentially higher cost of Vector and all other physical transportation options versus a swap arrangement is offset by the non-monetary benefits of a physical route".

Intervenors' Positions

3.8.4 CAC stated that the considerations bearing on the prudence of ECG's decisions to contract for capacity on the Vector pipeline are somewhat different from the considerations that apply to its decision to contract for capacity on the Alliance pipeline.

3.8.5 It was CAC's position that ECG's decisions to contract for Alliance capacity were not prudent. As a result of those decisions, ECG had a substantial volume of gas, arriving in the Chicago market, which it then had to move to Ontario. It is arguable, accordingly, that the decisions to contract for Vector capacity were necessitated by the imprudent decision to contract for Alliance and were, accordingly, imprudent. To put the matter another way, ratepayers should not have to bear the cost consequences of a decision itself necessitated by an imprudent decision.

3.8.6 However, had ECG contracted for capacity in the Chicago market, it would have had to move the gas to Ontario and, as a practical matter, Vector was the only alternative. From that perspective, the decision to contract for Vector capacity was a necessary one. A necessary decision is, arguably, neither an imprudent nor a prudent one.

3.8.7 In CAC's view, the open question is whether ECG, in 1999, should have considered purchasing gas at Dawn as an alternative to Vector. ECG's staff recognized, in the Dann Memo, that it would be cheaper to buy gas at Dawn. Mr. Dann offset, against that cost benefit, what he characterized as the "non-monetary benefits" of a physical route from Chicago. Those benefits included the following:

- diversity of supply sources from, among other places, the US. That is, in other words, the benefit of purchasing gas supply in the Chicago market, something ECG, as a matter of "policy", had been unwilling to consider in 1996; and
- increased natural gas trading liquidity and price transparency in Ontario.

3.8.8 CAC argued that these would result from the building of a pipeline. Mr. Dann could see these results for Ontario, but his colleagues were evidently not able to see the same results for Chicago from the combination of Northern Border and Alliance pipelines in 1996.

3.8.9 CAC asserted that the issue for the Board is whether it is clear, from the evidence, that ECG adequately considered Dawn as an alternative market. The problem in undertaking that analysis is in assessing ECG's conflict of interest. At the time that the decision was made to contract for Vector capacity, EI had a substantial interest in the Vector pipeline. The reality is that Mr. Dann's analysis of monetary and non-monetary benefits was academic since:

- the Alliance gas had to move out of Chicago; and
- EI had an investment in Vector which its subsidiary could support in monetary and non-monetary ways.

3.8.10 VECC argued that in the C. Serpanchy memo to L. Beattie, dated May 31, 1999, the opening statement of the letter seems to imply there is an expectation to contract on Vector as opposed to renewing some TCPL capacity as the memo opens with the following statement: We expect to contract for Vector Pipeline capacity of 79,000 Dth/d from Chicago.

3.9 VECTOR 2

ECG's Position

3.9.1 ECG's evidence was that it needed Vector 2 to replace ECG's corresponding FT service entitlements with TCPL. ECG was effectively "swapping" FT capacity from TCPL to Vector as opposed to serving market growth requirements.

3.9.2 ECG submitted that was mindful of concerns about trading, in effect, one-year renewable service entitlements with TCPL for Vector 2's 15-year service entitlement. ECG accordingly negotiated a "put/call" arrangement with EI whereby, if need be, ECG can convert Vector 2 into medium-term capacity. ECG pointed out that it now has the benefit of a lower toll, at the negotiated 15-year level with a U.S. $0.25/Dth rate cap, that would not otherwise be available.

3.9.3 ECG made its commitment to Vector 2 at a time when EI held a 45% ownership interest in Vector. EI was then one of three sponsors of the Vector project. ECG denied that there was a directive from EI to make a commitment to Vector 2. ECG instead maintained that it made its commitment because Vector 2 was cheaper than a renewal of ECG's corresponding FT service entitlements with TCPL.

3.9.4 ECG advised the Board that it examined delivered service and Dawn supply as alternatives to renewing ECG's corresponding FT service entitlements with TCPL. ECG submitted that it looked at the “cons” as well as the “pros” and selected Vector 2 instead of the non-physical alternatives for the following reasons:

- the cost of delivered service "is likely to rise as competition for delivered service increases with further non-renewals" even though, for comparative purposes, delivered service and Dawn supply "are deemed to be equal";
- although Vector 2 with Chicago supply is more expensive, "Dawn is not a very liquid market centre" and, without "adequate supply at Dawn to meet all future demand…provided by a pipeline, the prices at Dawn will rise as competition for limited supplies at Dawn increase rapidly"; and
- "[t]he potentially higher costs of Chicago (via Vector) over the Dawn supply option is off-set by the non-monetary benefits of a physical route listed below".

3.10 GENERAL COMMENTS ON ALLIANCE AND VECTOR

3.10.1 In Union’s submission, whether or not the Board finds that the initial presumption of prudence is overcome on the facts of this case, the record does lead to the conclusion, considering only the reasonableness of the decision in light of the circumstances that existed *at the time*, excluding all consideration of hindsight, that ECG acted prudently in contracting for upstream capacity on the Alliance and Vector pipelines.

3.10.2 CME was of the view that it was not prudent for ECG to enter into the Alliance and Vector long term contracts, particularly in circumstances where the contracts are with parties owned in part by ECG and/or its affiliates. In this regard, CME supported the position expressed by the CAC's expert witness, Mark P. Stauft, namely that there were more reasonable alternatives available to ECG than the Alliance/Vector option.

3.10.3 VECC argued that the pipeline ownership interests of ECG's parent EI were a significant, if not the primary, concern in the making of the decisions to contract for capacity on Alliance and Vector. VECC argued that there were numerous circumstances where the "conspicuous symmetry" of the actions of the utility and the interests of its parent are revealed.

3.10.4 VECC noted that the relevant decisions represent major financial commitments by ECG to new methods of gas supply. Unlike previous transportation paths, ECG would be contracting for capacity on pipeline systems owned by its parent.

3.10.5 VECC submitted that it is the reality of the cross ownership interests of EI that is the smoking gun for this issue, not the presence of a marching order from EI. It would also generally be thought to be incumbent on ECG to demonstrate that measures were taken to ensure independence in the face of the potential conflict.

3.10.6 VECC pointed out that there are some telling examples of the conflict available in the record of this proceeding. These include:

- ECG conceded that there were suggestions from EI favour of both Alliance and Vector ;

- ECG had communications with its parent concerning the development of transportation paths that would move the Chicago gas from Alliance Pipeline into pipelines owned by its parent EI;
- evidence provided in the proceeding appears to document an effort on the part of ECG to determine ways of using EI pipeline assets to move gas from Chicago to ECG s market and to assess what tolls are required from Chicago to the city gate to make the Alliance Pipeline competitive.

3.10.7 VECC pointed out that ECG never examined the Foothills/Northern Border pipelines as an alternative to bypass TCPL in the past, "an omission consistent with its affinity for its parent's project". The evidence suggested that ECG had never been in the queue for Transportation Services on the Foothills or Northern Border pipeline nor inquired about the 1998 expansion on the Northern Border system.

3.10.8 VECC submitted that there is little on the record to dispel the natural inference that ECG and its management acted, at all times, to favour its pipeline-owning parent. The evidence disclosed a trail of favouritism towards its parent's investment in the decisions of ECG, as well as providing evidence of demonstrable imprudence.

3.10.9 CAC submitted that the Board should find that ECG's decisions to contract for Alliance and Vector capacity were not prudently made. In the case of the decisions to contract for Alliance capacity, the Board should find that ECG failed to consider all reasonable alternatives, and in particular failed to consider the alternative of acquiring supply in the Chicago market.

3.10.10 With respect to both the Alliance and Vector contracts, CAC submitted that the Board should find that ECG has failed to prove that the contracts were made to benefit ratepayers as opposed to its parent, EI. In CAC's view, the evidence clearly points to a conflict of interest especially in light of the fact that Union and ECG are the only LDCs to contract for significant capacity on both pipelines, ones that their parents have a considerable interest in.

3.10.11 CAC is suspicious about the nature of Mr. Foster's retainer. Mr. Foster claimed that he was retained to provide an opinion on the prudence of ECG's decision to contract for capacity on Alliance and Vector. To support that opinion, Mr. Foster claimed that he had reviewed the record in this case. Yet at the time he delivered his opinion, in the form of his pre-filed evidence, the Otsason Memo and the Dann Memo, which are the only evidence of what ECG considered in reaching its decisions, were not yet part of the record. Accordingly, Mr. Foster arrived at his opinion without ever looking at what ECG considered. CAC submitted that the only reasonable conclusion is that Mr. Foster was retained to provide a patina of independence and respectability for ECG's own assertions.

3.10.12 CAC stated that it is clear that, with one exception, he has made no independent assessment but is relying on ECG's own assertions. The one exception is his contact with three, unidentified Chicago LDCs in an attempt, one presumes, to provide an independent assessment of the perception of the Chicago market. Not only does he not identify the three LDCs, he makes no effort to establish that what they purportedly say is representative of the entire market.

3.11 RELIEF AND REMEDIES

Relief Requested by ECG

3.11.1 ECG is seeking the following Board findings on the Alliance and Vector issue in this proceeding:

- The cost differential recorded in the Notional Deferral Account between ECG's new and traditional paths for the 10-month period preceding the test year is reasonable, under the circumstances, and so it is allowed in its entirety for rate-making purposes;
- The cost consequences of the new path for the test year are reasonable, under the circumstances, and so they are allowed in their entirety for rate-making purposes; and
- ECG's management was prudent in taking the actions that give rise to the cost consequences of the new path not only in the 10-month period, as reflected in the cost differential, but also in the test year.

Intervenors' Position

3.11.2 CAC submitted that the Board should find that:

- for the ten-month period, ECG should not be entitled to recover, in rates, the amount in the Notional Deferral Account; and
- for the 2002 Test Year, ECG should not be entitled to recover, in rates, the amount in the Notional Deferral Account.

3.11.3 With respect to the duration of the Alliance and Vector contracts, CAC submits that the following relief should be granted:

- that the Notional Deferral Account should be continued, but solely for the purpose of providing a short-hand means of assessing the outcome of the decisions to contract for Alliance and Vector capacity;
- that the Notional Deferral Account should be expanded to include calculation of the costs of acquiring similar volumes of gas at Chicago and Dawn;
- that, in each rate case, ECG should be required to submit evidence as to why it should be allowed to recover, in rates, more than the lowest cost of the four alternatives, namely Alliance/Vector, TCPL, Chicago and Dawn.

3.11.4 VECC did not agree with ECG's interpretation of the 2001 Settlement Agreement, to the effect that intervenors and the Board are precluded from examining in the 2001 fiscal year the Alliance and Vector cost consequences with the exception of the Notional Deferral Account. The Notional Deferral Account was established to facilitate the technical requirements of the resolution of the cost consequences issue, and was not intended to function as a substantive limitation.

3.11.5 VECC submitted that the Board should provide the financial impacts to ECG for fiscal 2001 on the cost differential associated with what the Board deems to be a prudent action versus the actual actions ECG has taken.

3.11.6 CME stated that ECG should be required to seek Board approval prior to entering into any contracts longer than the applicable period of regulatory review. Requiring ECG to obtain Board approval for long-term contracts (ie: longer than a PBR period) would help to ensure that ECG documents its "thought processes" and rationale for

pursuing certain options. Intervenors and the Board would be able to properly assess whether decisions affecting ratepayers are being made in their best.

3.12 BOARD COMMENTS AND FINDINGS

Review of Prudence

3.12.1 While the parties described it in somewhat varying terms, in the Board's view they were in substantial agreement on the general approach the Board should take to reviewing the prudence of a utility's decision.

3.12.2 The Board agrees that a review of prudence involves the following:

- Decisions made by the utility's management should generally be presumed to be prudent unless challenged on reasonable grounds.
- To be prudent, a decision must have been reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made.
- Hindsight should not be used in determining prudence, although consideration of the outcome of the decision may legitimately be used to overcome the presumption of prudence.
- Prudence must be determined in a retrospective factual inquiry, in that the evidence must be concerned with the time the decision was made and must be based on facts about the elements that could or did enter into the decision at the time.

3.12.3 While a party challenging the prudence of a decision made by the utility has an obligation to raise reasonable grounds for undertaking such a review, it does not need to establish a *prima facie* case that the utility's decision was imprudent; rather it must demonstrate that there is an issue to be determined on further inquiry by the Board. This is particularly true in the case of a regulated utility where it is the only party in

possession of all the relevant information about how and why the decision was in fact made.

3.12.4 A party can raise reasonable grounds through such means as an examination of the outcome of the decision, the inherent conflict of interest of related parties to a transaction and relevant industry practices at the time the decision was made.

3.12.5 Once a party has persuaded the Board that a prudence review is warranted, or, as some have put it, the presumption of prudence has been "overcome", the onus is then on ECG to demonstrate that the decision it made was prudent at the time.

3.12.6 The Board does not agree with ECG's assertion that other parties have an obligation to demonstrate that another course of action would, objectively, have been better than the one taken by ECG.

3.12.7 There were two bases on which the intervenors challenged the presumption of prudence of ECG's decisions:

- that there was an inherent conflict of interest between ECG and its parent, EI; and
- that the outcome of the decisions appeared to have resulted in a higher cost than might otherwise have been the case.

3.12.8 ECG argued that since it had consented to the issue of prudence being raised in this proceeding, there was no need for the Board to make a specific finding that the intervenors had raised reasonable grounds for a prudence review.

3.12.9 Notwithstanding ECG's consent that prudence would be an issue in this proceeding, the Board finds that it would be helpful in this case to make the specific finding that there is an inherent conflict of interest between the regulated utility and its affiliate or affiliates and that such conflict of interest is sufficient grounds to inquire into the prudence of the decisions made by ECG.

3.12.10 The Board agrees with ECG that EI and ECG may have had a shared interest in having the pipelines built; however, their interests were not always the same. For example, the Board notes that EI's interest as an investor in the pipeline was to ensure the project's profitability in order to maximize its own profits, while ECG's interest, as a regulated utility, was to obtain transportation service at the least reasonable cost.

3.12.11 While the fact that EI may have profited from these arrangements is not by itself sufficient evidence to establish that the arrangements were not prudent for ECG, it is, however, sufficient evidence to overcome the presumption of prudence and invite further inquiry by the Board.

3.12.12 The Board agrees with the intervenors that the outcome of a decision may also overcome the presumption of prudence. The Board notes that as the Notional Deferral Account used to track the cost differences between the two transportation paths has a balance in favour of the "traditional path", this also suggests that the prudence of ECG's decision should be examined.

3.12.13 The Board finds that the presumption of prudence has been overcome and that there are reasonable grounds to inquire into the prudence of ECG's decisions to enter into long term transportation arrangements with the Alliance and Vector pipelines.

Alliance 1

3.12.14 The Board's review of prudence of ECG's decision to enter into Alliance 1 centres largely on the Otsason Memo since ECG's evidence was that it summarized the factors taken into account by ECG in making its decision.

3.12.15 The Otsason Memo's rudimentary financial analysis presented a range of possible financial outcomes and concluded that the Alliance transportation path was likely to be more expensive than the NOVA/TCPL alternative with which it was compared. Therefore, ECG must satisfy the Board that it had good reasons for choosing this alternative.

3.12.16 The Board notes that several of the advantages, such as ECG's legitimate objectives of encouraging competition with TCPL and securing alternative sources of supply, would have occurred as a result of the Alliance pipeline being built irrespective of ECG's participation in the fall of 1996. At the same time, ECG's evidence was that ECG's participation was not crucial to ensuring that the pipeline was built.

3.12.17 While the Otsason Memo suggests that shipping through Alliance to Chicago would provide ECG with transactional service and arbitrage opportunities, the Board notes that these opportunities would exist only if Chicago were a functioning, liquid market. This position is consistent with Mr. Stauft's evidence that ECG should have

known that the Chicago market would develop by the time ECG would be in a position to ship gas through Alliance.

3.12.18 The Otsason Memo is inconsistent with ECG's witnesses testimony that the Chicago market was not, in their view, well developed and there was no way in 1996 that they could have foreseen that it would be. ECG's evidence was that at that time, the only alternatives they seriously considered were those that involved a physical transportation route from a supply source.

3.12.19 The Otsason Memo assumed that the ANR/MichCon/Link path would be used to complete the path from Chicago to Dawn, and ECG contracted on the basis of this assumption. However, the Otsason Memo made no comment about the likelihood of approval of the ANR/MichCon/Link path or its in-service date. In light of ECG's position that only a physical route from the supply basin was appropriate, the Board questions ECG's willingness to enter into a long term commitment with no assurances about the completion of the route.

3.12.20 One of the disadvantages identified in the Otsason Memo was the risk of in-service delays for the Alliance pipeline. This risk in fact materialized; the in-service date was delayed by over one year from November 1999 to December 2000.

3.12.21 One way ECG could have demonstrated the prudence of its decision was to provide the Board with evidence that it has considered and analyzed the full range of reasonable alternatives. Yet ECG did not provide evidence that it considered the effects of the Alliance pipeline on gas markets and other transportation alternatives. In addition, particularly in light of ECG's evidence that its participation was not required to build the Alliance pipeline, ECG has not provided the Board with

evidence that it evaluated the option of waiting until the Alliance pipeline was built before making a long term commitment.

3.12.22 The Board is not convinced by ECG's argument that there is an obligation on the intervenors to demonstrate that there was a better alternative available. To so require would be to allow ECG's decisions to in effect "win by default".

3.12.23 Based on the evidence, the Board is not satisfied that ECG's decision to enter into the Alliance 1 contract in 1996 was prudent.

Alliance 2

3.12.24 While ECG argued that it entered into Alliance 2 because it required additional capacity to meet projected market growth, it provided the Board with limited evidence to support this position. The Board's concerns with respect to Alliance 1 are equally applicable to Alliance 2.

3.12.25 In addition, the Board notes that at the time ECG entered into Alliance 2, there was still a measure of uncertainty surrounding the transportation of gas from the western supply basin to Ontario. The Alliance pipeline had still not been approved by the NEB, although FERC preliminary approval had been granted in August 1997. Further, it appeared that ANR/MichCon/Link was not going to proceed but EI was proposing the construction of the Vector pipeline, although no application for approval had yet been filed with the appropriate regulators.

3.12.26 The Board notes that AEC transferred its ownership interest in Alliance to EI at the same time that ECG increased its commitment to Alliance by a similar percentage. While ECG denied being directed by EI to assume the additional capacity, the Board remains unconvinced that ECG was not influenced by EI in some way.

3.12.27 Particularly in the absence of independent additional analysis, the Board is not satisfied that ECG's decision to enter into the Alliance 2 contracts in 1997 was prudent.

Vector 1

3.12.28 The Board acknowledged that with the demise of the ANR/MichCon/Link route ECG was faced with the requirement to complete the transportation path from Chicago to Dawn.

3.12.29 ECG provided evidence that it analyzed the two options reasonably available to it at the time: gas swaps between Chicago and Dawn, and a physical pipeline route. The Board also notes that in the case of Vector 1, ECG did not make a firm commitment pipeline until it had received regulatory approval.

3.12.30 The Board does not agree with CAC that once an imprudent decision has been made, all decisions flowing from it are also imprudent. The Board notes that ECG has an ongoing obligation to review and mitigate the consequences of all of its decisions.

3.12.31 Under the circumstances, the Board agrees with ECG that contracting on Vector to complete the path from Chicago to Dawn was a reasonable decision. The Board finds that ECG's decision to enter into the Vector 1 contract in 1999 was prudent.

Vector 2

3.12.32 While ECG advised the Board that it entered into the Vector 2 contract in order to replace expiring capacity on TCPL, it did not provide the Board with sufficient evidence and analysis, including alternatives, to justify this decision.

3.12.33 The Board notes that the Vector 2 decision was independent from its previous decisions to enter into the Alliance 1 and 2 and Vector 1 contracts and was not required in order to complete the single continuous transportation path from the western Canada supply basin to southern Ontario. In addition, the Board notes that the cost consequences of the Vector 2 contract were not included in the calculation of the Notional Deferral Account, which is a key element of the Board's prudence review of the Alliance and Vector arrangements.

3.12.34 As a result, the Board is not prepared at this time to make a determination of the prudence of ECG's decision to enter into the Vector 2 contract.

Relief and Remedies

3.12.35 The Board notes that the parties agreed in the 2001 Settlement Proposal to establish the Notional Deferral Account as a means, among others, of ascertaining whether the entire cost differential should be allowed for rate making purposes and, if not, the amount that should be disallowed.

3.12.36 The Notional Deferral Account was intended as a measure to ascertain whether the cost differential between the old and the new paths was substantial, such that it would raise the issue of whether the presumption of prudence had been overcome. It was not intended as a method of determining the cost consequences and any potential disallowance of costs if the Board were to find that entering into the Alliance and Vector agreements were not prudent.

3.12.37 Based on the Board's finding that the Alliance 1 and Alliance 2 contracts were not prudent, the Board is not prepared to grant ECG's request to allow the full amount of $12.4 million recorded in the Notional Deferral Account to be recovered from ratepayers.

3.12.38 The Board notes that ECG's evidence indicates that of the $12.4 million in the Notional Deferral Account, $11.0 million is attributable to the fact "ECG suppliers for the new path were concerned about the uncertainty of Alliance's December 1st in-service date, in light of previous delays, and so they insisted on spot pricing rather than monthly pricing for December 2000. There was a price spike during the month that drove spot prices much higher than monthly prices. "

3.12.39 The Board notes that the "considerably higher risks of in-service delays" was one of the disadvantages of the Alliance pipeline specifically identified in the Otsason Memo. The Board is not satisfied that ECG took appropriate action to mitigate this identified risk. As a result, the Board finds that $11.0 million is an appropriate amount reasonably attributable to these delays.

3.12.40 The Board is not prepared to continue or expand the basis of the Notional Deferral Account as suggested by CAC: it is a one-time disallowance. The Board finds that it is neither reasonable nor practical to continue to examine the cost differential in future rates cases, as suggested by CAC.

3.12.41 The Board directs ECG to credit $11.0 million to the 2002 PGVA and to provide the Board with sufficient evidence of this credit when dealing with the clearance of the 2002 PGVA in the 2003 rates proceeding.

4. SYSTEM GAS

4.1 BACKGROUND

4.1.1 As part of the 2001 Settlement Proposal, ECG undertook to conduct a study of the existing gas supply management costs which are assigned to its system gas and direct purchase customers. The study (the "2002 FAC Study") was to use the fully allocated costing methodology and was to examine, in detail, the existing cost allocation methodology which results in the assignment of gas supply management costs to system gas customers and to direct purchase customers.

4.1.2 In addition, ECG agreed to retain a consultant to undertake an examination of the hypothetical costs of managing system gas as a discrete business, on a stand-alone basis. The consultant was also to ascertain how these costs would vary from those costs allocated to system gas customers in 2002 FAC Study.

4.1.3 The Company filed both the 2002 FAC Study and the consultant's report in this proceeding.

4.1.4 Because of the link between the issues of the cost allocation of gas supply management costs (Issue 2.3) and the cost of managing system gas on a "stand-alone" basis (Issue 2.4) the Board has considered them together.

4.2 THE FULLY ALLOCATED COST STUDY

4.2.1 The Company advised the Board that the 2002 FAC Study was limited, because TPBR allowed the Company flexibility in managing its operations and maintenance ("O&M") expenditures within a total envelope approach, and as such the Company was not required to forecast or report on its O&M expenditures on an account by account basis for rate making purposes. Consequently ECG was not able to use "an account-level forecast" of its O&M expenditures for the 2002 FAC Study.

4.2.2 As a result, ECG based the 2002 FAC Study on 1999 data. The Company advised the Board that as a first step it adjusted the 1999 level of O&M expenditures annually in accordance with the TPBR formula up to, and including, the 2002 Test Year. Then, as a second step, ECG assigned an appropriate amount of corporate overheads, or administrative and general ("A&G") expenses, to the system gas and to the direct purchase accounts, in order for costs to be assigned on a fully allocated, rather than incremental, basis. That process resulted in the following for the 2002 Test Year:

	System Gas	Direct Purchase
O&M expenses	$886,758	$1,152,982
A&G expenses	$154,048	$ 200,296
FAC	$1,040,806	$1,353,278

4.2.3 ECG recognized the shortcomings of the 2002 FAC Study and proposed to file an updated study (the "2003 FAC Study") in the 2003 rates case. ECG proposed that the 2003 FAC Study would :

- examine the functions and tasks being performed by ECG and its affiliates to manage the system gas and direct purchase functions;
- determine the level of expenditures based on the 2003 cost of service budget;
- determine the cost drivers behind each of the expenditures;
- assign the appropriate level of A&G expenses; and
- review the existing methods of cost recovery.

4.3 THE STAND-ALONE STUDY

4.3.1 ECG retained James B. Bracken CA, of Bracken Consulting, to prepare a report entitled a "Report on Cost of Managing System Gas Supply"(the "Bracken Report") on the costs of managing system gas on a stand-alone basis. The Bracken Report was filed in this proceeding.

4.3.2 The main conclusion of the Bracken Report was that a hypothetical, stand-alone operation to manage system gas supply for ECG would cost $684,054 per annum. The Bracken Report identified and costed the following functional areas for gas supply and system balancing:

- Gas Supply Planning
- Gas Acquisition
- Risk Management
- Contract Management
- Gas Control
- Nominations
- Invoice Processing and Payment

4.4 POSITION OF PARTIES

4.4.1 CEED challenged ECG's cost allocation and also its fairness of treatment in managing system gas and direct purchase gas. IGUA, in its argument, generally supported CEED's position. CAC and VECC each generally supported the Company's position. CME, HVAC and Schools made no submissions on this issue.

4.4.2 CEED's position was that distribution customers should receive equitable distribution service regardless of whether they are supplied by ECG as a system gas supplier, or supplied by a marketer/shipper, as in direct purchase gas supply. CEED argued that ECG uses distribution system assets to provide system gas to its customers in a manner that is preferential to the way in which these assets are available to marketers to provide gas to their direct purchase customers.

4.4.3 CEED asserted that the advantages conferred by the Company on system gas customers include:

- providing system balancing services without the risk of charges arising from out-of-balance penalties;
- providing system supply data to their system gas supplier, not available to the suppliers of direct purchase customers; and
- making storage and transportation facilities available to their system gas supplier, on a priority basis, over those available to the suppliers of direct purchase customers.

4.4.4 CEED took issue with the approach taken in the Bracken Report and contended that the Bracken Report had not identified all of the functions, and the associated costs, that would be required by a person who provided system gas on a stand-alone basis; that is, separated from distribution service *per se*, in a manner similar to direct purchase gas, instead of integrated with distribution service, as is now the case.

4.4.5 CEED requested that the Board require ECG to carry out the 2003 FAC Study to identify all of the resources made available to balance and bill and collect from system gas customers and ensure that the costs of these resources are fully recovered by system gas customers on a fully allocated basis.

4.4.6 In addition CEED requested that services provided by the Company to both system gas and direct purchase customers be made more "equivalent" and that the Board issue the following directives:

- that ECG keep a record of all gas purchased for and consumed by system gas customers in an annual period. Where the amount of gas purchased either exceeds or is less than the amount consumed by system gas customers, then ECG is to apply a balancing fee to such difference (the out of balance quantity). The balancing fee is to be determined by multiplying the volume of the out of balance quantity times 20% of ECG's WACOG. The revenues resulting from the balancing fee should be used as a credit towards distribution revenues;
- that ECG provide all direct purchase customers, or their agents with access to all system supply planning information that it has available to purchase gas supply for system gas customers;
- that, prior to releasing storage and transportation assets to the "S&T business" (whether carried out within ECG or through a third party), ECG offer these

assets to direct purchase customers who may make use of them to bring their Banked Gas Accounts ("BGAs") into balance; and

- that ECG not be permitted to charge balance penalties to any customer who was out of balance as a result of reporting error by ECG.

4.4.7 With respect to CEED's request for changes to the 2003 FAC Study, IGUA submitted that when preparing its 2003 FAC Study and stand-alone cost studies for the 2003 Test Year, ECG should include the costs associated with the additional functions, as suggested by CEED.

4.4.8 IGUA suggested that it would enhance the understanding of the issue if the 2003 FAC Study were provided in two formats: the first encompassing the functions which ECG asserted were appropriate for each study; and a supplemental presentation which would include and demonstrate the impact on the ECG approach of including the costs associated with the additional functions which CEED contended should be taken into account.

4.4.9 IGUA submitted that the "provision of the cost information in this way should provide a better information base than that which is currently available and thereby facilitate a further and better evaluation of the extent to which the principle of equivalency is being misapplied by ECG."

4.4.10 CAC agreed with ECG that direct purchase and system gas service are not the same type of service and accordingly they should not necessarily be priced on the same basis. CAC also did not accept the proposition that the direct purchase and system gas services should be allocated the same level of costs if those costs are not reflective of providing those different services.

4.4.11 CAC indicated that it shared the concerns of the retailers that it is important to ensure that the provision of system supply is not cross-subsidized, and that "direct purchase not be allocated costs unrelated to the provision of the service".

4.4.12 CAC submitted that a detailed examination of the various cost elements is required in the next proceeding. If a detailed cost study is provided, parties should be able to assess the various functions required to provide the services and determine whether ECG's allocation of the costs to provide those functions is appropriate. To the extent that parties require specific information from ECG in order to effectively examine these issues in the next proceeding, ECG should be required to provide that information as a part of its pre-filed evidence.

4.4.13 VECC supported the Company's position largely on the assertion that "system gas and direct purchase are not the same thing".

4.5 THE COMPANY'S POSITION

4.5.1 ECG clarified its understanding of the term "system gas" to mean not only the gas purchased for sale to customers as sales service, which is discrete from distribution service, but also gas purchased for load balancing purposes for all customers. ECG asserted that it cannot distinguish, when procuring system gas, between gas destined for delivery and sale, including load balancing, to sales service customers, and gas destined for delivery only, as load balancing, to direct purchase customers.

4.5.2 ECG explained that, in operational terms, load balancing as it exists today, "is a distribution service provided to all of ECG's customers, both direct purchase and system, at the same rates. With equivalent rates applicable to both customer groups, no group is benefitting at the expense of the other."

4.5.3 ECG argued that fees charged for being out of balance are not penalties but are Board-approved rates designed to provide transportation service ("T-Service") customers, or their agents, with an incentive to manage volumetric imbalances in their BGAs. ECG described the fee as a "deterrent to the use of system gas as a swing supply because such a use is, in effect, subsidized by system gas customers and other direct purchase customers".

4.5.4 In ECG's view, these fees for being out of balance recognize that the actions of some direct purchase customers, or their agents, could have some bearing on costs recovered from system gas customers through the disposition of the commodity variance in the PGVA

4.5.5 ECG pointed out that T-Service customers or their agents have the opportunity to take appropriate action to bring themselves within the tolerance levels and that these customers make their own decisions on what actions to take. On this issue, the Company's witness, Mr. Bracken, made the following points in his testimony:

> This schedule doesn't give us any description at all on what the direct purchase marketers were doing and what some of the economic consequences of the decisions that they were making during the year were. They get monthly information on what actual consumption is, they can compare that to their Mean Daily Volumes ("MDV"), and they can see these imbalances building or accumulating. They have a choice to make as to how soon and when they want to react to that. This doesn't show us in here any place what decisions they've made

> in deferring decisions, deferring the choice to make up some imbalances and incurring some prices in market at that time.
>
> In other words, they could have decided that they are seeing an imbalance and these prices may have been better for them than other prices they might have otherwise incurred.

4.5.6 ECG disagreed with CEED's contention that ECG, as the supplier of system gas, should be subject to the same imbalance penalties as direct purchase suppliers. ECG denied that the role, functions and obligations of ECG as a supplier of system gas are comparable to those of the suppliers of direct purchase gas.

4.5.7 ECG stated that with respect to load balancing, T-Service and system gas customers are different in that T-Service customers or their agents deliver their MDVs on a daily basis. When a difference occurs between actual consumption and an MDV, ECG will either supply the commodity or store/divert any excess gas by using load balancing tools. The only obligation on T-Service customers, or their agents, is to true-up, at the end of a contract year, for any cumulative difference between the volume of gas delivered -- the sum of the MDVs – and the volume of gas consumed.

4.5.8 For system gas customers, ECG pointed out that as a distributor, it must ensure that the volume of gas delivered matches, on a daily basis, the volume of gas consumed. On the issue of including a notional BGA, ECG asserted that if system gas customers were to have such a notional BGA, they would be required to balance it, to zero, on a daily basis. In ECG's view, this requirement would be far more onerous than the annual balancing obligation of direct purchase customers or their agents.

4.5.9 ECG also took exception to the suggestion that billing and collection costs, as they relate to system gas, should be attributable to a stand-alone supplier of system gas solely because a marketer "internalizes" these costs. ECG argued that a stand-alone supplier of system gas is a supplier of gas to ECG, not end-use customers, because ECG still offers sales service. There is no need, in other words, for the stand-alone supplier to have a billing and collection function directly or, like all marketers to date, indirectly through ECG's agency, billing and collection ("ABC") service.

4.5.10 ECG submitted that it would be unfair to require ECG to forego billing and collecting the costs of providing sales service as well as distribution service *per se*. ECG bills in excess of 1.5 million customers per month and the related costs, for the most part, are fixed costs. To remove system gas customers prematurely, then, would expose ECG to stranded costs

4.5.11 In summary then, ECG's position was that the Bracken Report properly identified the functions necessary to manage system gas on a stand-alone basis. ECG therefore proposed to use functions identified in the Bracken Report for the purpose of preparing its 2003 FAC Study.

4.6 BOARD FINDINGS

4.6.1 The Board notes that direct purchase customers or their agents are treated differently from system gas customers. This includes different treatment with respect to the responsibility and accountability associated with balancing, fees for billing and collection, access to storage and transportation assets for use in mitigating volumetric imbalances, and access to current information for gas supply planning.

4.6.2 The Board is not convinced by the Company's argument that the operational differences between system gas and direct purchase gas are, by themselves, sufficient to justify the differences in treatment by the Company.

4.6.3 In reviewing this issue the Board would be assisted if the 2003 FAC study were expanded to include a detailed analysis of each service received by system gas customers in comparison to direct purchase customers.

4.6.4 The Board directs the Company to file the 2003 FAC study in two formats, as proposed by IGUA. One format will be in the format proposed by the Company; and the second format will be in the format proposed by CEED, which would identify and quantify all of the resources used by the Company to balance, and to bill and collect from system gas customers. The Board expects that both formats will be fully costed out and appropriately presented so that the Board can make meaningful comparisons between the two approaches.

4.6.5 The Board understands that the Company intends to bring a comprehensive rate restructuring application before the Board in the near future. Further, the Board is aware that the costs of the services under review in the 2003 FAC study are only a few of the many costs being apportioned among gas distribution customers. Since the matters to be dealt with in the 2003 FAC study are an aspect of cost allocation and rate design, which is related to rate restructuring, in the Board's view the 2003 FAC study would be most appropriately dealt with as part of any Company rate restructuring proposal.

4.6.6 The Board denies CEED's request that the Board direct the Company to render service levels more "equivalent", as it is premature. The Board is not satisfied that there is sufficient evidence in this proceeding to support CEED's request.

5. AFFILIATE OUTSOURCING

5.1 BACKGROUND

5.1.1 ECG's outsourcing began in the mid-1990s when business services, such as human resources, insurance, taxation, capital markets, public affairs, and audit were centralized with ECG's affiliate and ultimate parent, Enbridge Inc. ("EI"). These initial outsourcing arrangements were renewed and formalized in a series of agreements dated January 1, 2000.

5.1.2 In this proceeding, the intervenors expressed particular concern about outsourcing arrangements with the following affiliates:

- Enbridge Commercial Services Inc. - customer care services;
- Enbridge Operational Services Inc. - operational services;
- Enbridge Inc. - gas services;
- CustomerWorks Limited Partnership - customer care services; and
- Accenture Inc. - customer care services.

Enbridge Commercial Services Inc.

5.1.3 In 1999, as part of the unbundling of competitive businesses from monopoly utility operations, ECG transferred approximately 570 full-time equivalent employees ("FTEs") and the following competitive businesses to its affiliate, Enbridge Services Inc. ("ESI"): appliance sales, furnace and hot water heater rentals, appliance repair service, home renovation, insurance and financing.

5.1.4 On January 1, 2000, ECG transferred approximately 1,110 FTEs and the CIS and to a new affiliate, Enbridge Commercial Services Inc. ("ECS"), and entered into an agreement to procure the following services from ECS: customer care, including customer billing, collections and the customer call centre, information technology, fleet management, and payroll, including payroll administration, maintenance of employee-related data, benefits administration and an employee service centre.

5.1.5 ECG did not disclose its intention to transfer these business activities to the Board and intervenors during its fiscal 2000 rates case (RP-1999-0001). As a result IGUA, CAC and VECC brought a motion dated June 29, 2000 (the "Motion") for the Board to review and vary certain aspects of its RP-1999-0001 Decision. In particular the moving parties requested that the Board:

- review and vary those portions of the Board's decision relating the determination of ECG's operational and maintenance ("O&M") expenses, rate base, depreciation and amortization expense, return on rate base, income taxes, and gross revenue deficiency for ECG's fiscal year;

- declare the 2000 rates interim pending final disposition of the request for review and variance;
- order ECG to make full and complete disclosure of the particulars of the outsourcing plan, including requiring ECG to record all payments made in appropriate deferral accounts;
- provide for a hearing and determination on the extent to which the 2000 rates ought to be adjusted as a result of the outsourcing; and
- direct ECG to file rate base and other cost of service information for the 2000 bridge year and the 2001 test year in the traditional cost of service format in its next rates application.

5.1.6 On June 29, 2000 the Board issued it decision ("Decision on the Motion"), indicating that although the Board was not convinced that ECG adequately disclosed its outsourcing plan, the Board was reluctant to reopen the Targeted O&M PBR Plan ("TPBR Plan") early in its term. The Board did, however, order that ECG record the financial impact of the outsourcing, except for O&M expenses in a deferral account. The disposition of the deferral account was dealt with as part of the settlement in the RP-2000-0040 proceeding, which set rates for ECG's 2001 fiscal year.

5.1.7 As discussed in greater detail below, effective January 1, 2002, ECS entered into a five year agreement ("Client Services Agreement") with CustomerWorks Limited Partnership ("CustomerWorks" or CWLP") for CWLP to provide ECG with the customer care services previously provided by ECS. CustomerWorks is a limited partnership owned 70% by EI and 30% by BC Gas Utility Inc.("BC Gas") or an affiliate of BC Gas.

5.1.8 At the oral hearing in this proceeding ECG advised the Board that as a result of EI's sale of Enbridge Services Inc.("ESI") to a division of Centrica plc, ESI had decided to repatriate the services presently being provided by ECS. Since this would result in ECG becoming ECS's only customer, ECG is also considering repatriating the services that are now outsourced to ECS.

Enbridge Operational Services Inc.

5.1.9 On October 1, 2000 ECG entered into a seven-year agreement (the "Intercorporate Services Agreement") with its affiliate, Enbridge Operational Services Inc. ("EOS"), to procure the following services from EOS at its offices in Edmonton, Alberta: gas control, nominations, and scheduling, and reconciliation services (collectively "Operational Services").

5.1.10 ECG first advised the Board of its decision to "centralize part of the gas supply operations functions" to Edmonton in a letter to the Board's chair, Mr. Floyd Laughren, dated August 1, 2000:

> An extensive evaluation of the entire operating control centre functions across the Enbridge organization was conducted with the objective of maximizing operating efficiencies. We are now moving forward to create an energy operating control centre in Edmonton that will consolidate the control centre facilities for both liquids and gas operations.
>
> By centralizing these key operating functions, in addition to operating efficiencies, we expect to achieve synergies in the form of centralized software support and consistent training and procedures. The opportunity for cross-functional training will provide additional ongoing support to the gas functions. The presence of additional employees from other control functions will provide improved support and response to medical emergency situations that could occur after-hours.

Enbridge Inc.

5.1.11 On July 1, 2001 ECG entered into agreements (the "Master Agreement" and "Agency Agreement"), expiring September 30, 2004, with EI to procure the following services from EI at its offices in Calgary, Alberta: gas supply planning, gas supply acquisition, risk management, contract management, transactional services (including assignments, exchanges, load balancing, loans, and off-peak storage) and regulatory support (collectively, "Gas Services").

5.1.12 The Agency Agreement allows EI to engage in gas acquisition, gas sales, gas supply management, and gas storage as a principal for its own account. EI is not entitled, on the other hand, to act as a principal for its own account when providing gas supply acquisition and transactional services to ECG until protocols are in place for the disclosure to, and approval by, ECG of any transaction in which EI would be ECG's counterparty.

5.1.13 ECG advised the Board of its decision to move its employees to Calgary to perform gas supply and transactional services in a letter to the Board Chair, Mr. Floyd Laughren, dated April 17, 2001. ECG stated that "all twelve employees ... will remain as employees of Enbridge Consumers Gas."

CustomerWorks Limited Partnership

5.1.14 Effective January 1, 2002, ECG entered into a five-year agreement (the "Client Services Agreement") with CustomerWorks to procure the following customer care services, previously provided by ECG: meter reading, billing, call centres, credit and collections, e-commerce and field work appointment scheduling such as meter

exchanges (collectively, "Customer Care Services"). ECG advised the Board that in addition to ECG, CustomerWorks also provides services to ESI, BC Gas and Enbridge Gas New Brunswick Inc.

Accenture Inc.

5.1.15 Subsequent to the oral hearing in this proceeding, on July 19, 2002, ECG advised the Board and the intervenors that CustomerWorks entered into an agreement with an affiliate of Accenture Inc., formerly Andersen Consulting, to assume the responsibility for the performance of the CustomerWorks' customer service obligations to ECG. ECG submitted that the transaction did not affect the nature of the affiliate outsourcing presented in evidence in this proceeding and should therefore have no impact on the arguments presented to the Board. In addition, ECG claimed that the existing Client Services Agreement between CustomerWorks and ECG would not change as a result of the transaction between Accenture and CustomerWorks.

5.2 THE ISSUE

5.2.1 The scope of this issue was developed through the settlement process and defined in paragraph 5.3 of the Settlement Proposal which, in part, provides as follows:

> The policy aspect of this issue can be stated in the form of two questions. Should the Board restrict or otherwise condition ECG's outsourcing of utility functions by including terms and conditions to this effect in its rate order? And if so, what terms and conditions would be appropriate?

5.3 AFFILIATE OUTSOURCING - GENERAL COMMENTS

5.3.1 CME, CEED, HVAC, IGUA, Schools and VECC each made comments raising concerns with respect to ECG's outsourcing arrangements. They are collectively referred to as "Intervenors" in this chapter. Union also made comments; however, they were in support of ECG's position.

5.3.2 ECG took the position that its outsourcing arrangements with affiliates are on-going and in effect. These arrangements were not and are not required to be authorized by the Board prior to their effective date or during their currency. ECG argued that this was confirmed by the Board in its Decision on the Motion.

5.3.3 ECG argued that the Board's jurisdiction with respect to ECG's outsourcing arrangements is limited to rate-making. Since these outsourcing fees are a component of ECG's O&M expenses and are, accordingly, included in ECG's TPBR Plan for the 2002 Test Year, the outsourcing arrangements have no impact on rates in the 2002 Test Year. ECG submitted that neither the methods that were used to determine the fees payable by ECG under its outsourcing arrangements nor the level of these fees, is an issue in this proceeding. The costs consequences of these arrangements will be examined in the context of ECG's application for Fiscal 2003 rates.

5.3.4 Union agreed with ECG that since ECG's outsourcing arrangements do not affect 2002 rates, the outsourcing issue is, in this sense, indistinguishable from the DPWAMS issue, which the Board has already held would not be dealt with in this hearing. Union argued that since there is no rate issue for the Board to determine in

this proceeding it is"unnecessary and inadvisable" for the Board to comment on the affiliate outsourcing issue at all.

5.3.5 Intervenors argued that the Board has both the jurisdiction and obligation to consider implications of outsourcing beyond simply its cost consequences. As a regulated utility providing monopoly services to its ratepayers, ECG cannot be permitted to circumvent regulatory oversight by creating unregulated affiliates to perform utility functions. To take ECG's argument to its logical conclusion would mean that the if the utility completely failed to fulfil its basic distribution service obligations, the Board would only have the jurisdiction to deny cost recovery in rates.rvice.

5.3.6 The specific concerns raised by the parties are grouped and summarized as follows:

- Extent and Nature of the Services being Outsourced
- Motives for Outsourcing
- Potential Consequences of Outsourcing
- Specific Concerns of ECG's Outsourcing Arrangements
- Transfer Pricing
- Transfer of Utility Functions
- Remedies and Jurisdiction

5.4 EXTENT AND NATURE OF THE SERVICES BEING OUTSOURCED

5.4.1 ECG pointed out that it has, over the years, outsourced many utility functions to unaffiliated third parties. Its more recent decisions to outsource other utility functions to affiliates simply reflects a North American trend of industry restructuring and consolidation, in order to "enhance business effectiveness and customer service and achieve operational and cost efficiencies". ECG argued that its

witnesses testified that the outsourcing of critical functions, such as gas control, is common in the natural gas industry.

5.4.2 A number of Intervenors commented that although the outsourcing arose primarily because of concerns about ECG's arrangements to outsource Gas Services to EI and Operational Services to EOS, concern about this issue increased when Intervenors became aware of the extent of the outsourcing.

5.4.3 HVAC argued that while ECG's evidence is that the utility has been outsourcing elements of its operations for years, historically most of that outsourcing has been to "unrelated service providers" in three areas:

- appliance inspections and new customer connections/unlocks;
- construction and engineering of the pipes and related infrastructure; and
- discrete consulting retainers in strategic business areas such as marketing technology, communications and DSM.

5.4.4 HVAC submitted that what is new in this proceeding is:

- the scale of the outsourcing;
- that ECG has outsourced control and operation of its basic utility mandate; gas acquisition, distribution system control and, as an adjunct thereto, customer care; and .
- that these operations have essentially been outsourced as complete operations, rather than as isolated construction or consulting assignments (even with the ultimate formal accountability to utility personnel).

5.4.5 HVAC commented that the degree to which ECG has outsourced its core utility functions, and the fact that these have been outsourced to affiliates of ECG, will adversely affect ratepayers or competitors of EI and ECG, or both, and therefore, these outsourcing arrangements are not in the public interest.

5.4.6 Schools noted that in the last two years ECG has outsourced over 15 separate utility business functions to affiliated companies in the Enbridge Group. These arrangements have been made pursuant to a general reorganization of the Group which places many business activities in unregulated companies in the Group. Schools contends that this reorganization of business functions has meant that today 54% of ECG's O&M budget consists of contractual payments to affiliates of ECG. Employment has dropped from 4,500 in 1995-96 to 1,700 people today. Schools argued that the utility is becoming "systematically eviscerated", and will, if the current trend persists, in a few years time become a "virtual utility".

5.4.7 Schools suggested that the first outsourcing of a complete business function, such as billing and customer care or gas services over a multi-year period, is different from contracting with a third party on a short-term basis to do a specific task, for example a specific mains extensions. Outsourcing raises different issues than simple contracting for services, including, scale, loss of independence of action, vulnerability to failure of the partner, diminished management control of the people performing the work and therefore, the business functions and an attenuation of regulatory oversight.

5.4.8 IGUA argued that the fact that ECG has, over the years, outsourced many functions to unaffiliated third parties pursuant to a public tender process and ECG's contention that there is a North American industry trend to outsource the performance of utility functions to unaffiliated third parties are facts which, in IGUA's view, have little relevance to the implications of the outsourcing arrangements which are being scrutinized in this case.

5.4.9 All parties agreed that gas services are critical to the operation of the utility. Schools pointed out that ECG's evidence is that it viewed the function as too "important and too derived from its own expertise" to contemplate an unaffiliated third party providing the services". Schools argued that the gas services activity is clearly part of the core function of the utility, utilizes utility assets, and is fundamental to the safe and secure supply for all the utility's customers, both system gas and direct purchase.

5.4.10 Schools pointed out that ECG has agreed that the functions being transferred were monopoly utility functions, ones that could not be easily replicated, and ones that are vital to the integrity of the utility and its safe and secure operation.

5.4.11 Schools observed, with respect to the transfer of Operational Services to EOS that :

- the expertise for the gas control function was in ECG and not EOS; indeed EOS was a new company, created in part to perform functions carried on by gas control personnel at ECG;
- the functions has not changed, only the venue;
- there was no compelling reason to create the new company;
- ECG could easily have made the SCADA investments itself; although to the extent the expenditures were not closed to rate base prior to October 31,

2003, it would have been at risk for the expenditure under a price/revenue cap PBR regime;

- supervisor oversight could have been rationalized in Toronto, at about the same cost as transferring th functions to Edmonton;
- the costs to comply with rule changes (if there are any) have to be recovered in any event;
- the Company's evidence is that under the EOS contract it is being charged the utility's avoided costs for a seven year period and given that there are no evident market benchmarks for this monopoly service, ECG is effectively locked in to pay its avoided costs from day one over seven years;
- since ECG already provided similar services to St Lawrence Gas, Gas New Brunswick and Gazifere, providing services to these entities was not a reason for the transfer;
- to earn a return from the business activity of over 17.5% on the total capital investment in the SCADA system compared with 9.7% had ECG made the investment;
- the arrangements allow EOS to potentially realize some economies of scale or scope by combining the gas control centre with an enlarged liquids control centre without having to pass any of the resulting savings on to ECG;
- the transfer of the function allows EOS the opportunity to provide these business services to other gas distributors, and other entities in the water and electricity industries using the software, training and trained personnel provided by ECG;
- transferring the business to EOS forecloses a third party from bidding for ECG's gas control business; competition in the business was deemed to be imminent; and

- the Board was never asked to approve this initiative and this issue was never seriously discussed by the parties.

5.4.12 In Schools' view, the Board should not permit a business function that is so vital to the continued integrity of the utility to be performed by a third party, affiliated or otherwise, for the following reasons;

- the transfer compromises the independence and integrity of the utility;
- the financial viability of EOS is not assured;
- given the long term fixed price nature of the EOS contract, and the lack of market comparators, there is no way to precipitate lower costs and transfer part of the consequent savings to ratepayers; and
- there is no compelling rationale for the transfer from ECG's point of view.

5.4.13 IGUA agreed that the performance of Operational and Gas Services is essential and critical to the performance by ECG of the monopoly function of physically transmitting, distributing and/or storing gas and selling gas as a regulated supply service. Together EI, EOS and ECG control the physical flows of gas in and out of ECG's transmission, distribution and storage assets.

5.5 MOTIVES FOR OUTSOURCING

5.5.1 ECG submitted that its decision to outsource its Operational Services to EOS was driven by:

- concerns regarding system reliability and security of supply; and
- the opportunity to maximize operating efficiencies.

5.5.2 ECG argued that three specific factors influenced ECG's decision:

- the unique staffing requirements associated with gas control operations;
- the need to replace ECG's Supervisory Control And Data Administration ("SCADA") system; and
- EI's plans to consolidate the control functions of its liquids pipelines.

5.5.3 ECG argued that with respect to staffing requirements, it had concerns about its ability to provide back-up supervisory coverage for its 24-hour, seven days a week gas control operations in a cost effective manner. With respect to the SCADA system, ECG considered the fact that its existing system needed to be replaced at a considerable cost. With respect to EI's plans to consolidate the control functions of its liquids pipelines, ECG considered the associated opportunities for achieving synergies under a consolidated operation an advantage as there would be improved supervision of its gas control function, whereby more supervisors would manage a larger group of individuals, and the risks inherent in operating with a single supervisor would be reduced.

5.5.4 ECG advised the Board that its decision to outsource its Gas Services to EI was "driven by the opportunity to achieve benefits in the form of cost efficiencies and improved service quality". ECG argued that "EI can provide Gas Services more efficiently than ECG because it provides such services on behalf of three affiliates and for its own account" and that ECG is precluded from providing gas services to third parties under its current Undertakings (Undertakings of The Consumers' Gas Company Ltd. et al dated December 7, 1998.)

5.5.5 ECG claimed that cost efficiencies and improved service quality could be achieved as a result of the access to the specialized expertise and "market intelligence" available in Calgary and that in the Company's view, similar benefits cannot be realized in Toronto. ECG's witnesses testified about the difficulty of managing Gas Services and the benefits of being able to draw upon expertise in Calgary to manage, for example, ECG's contractual assets on the Alliance Vector pipeline systems.

5.5.6 However, a number of Intervenors questioned ECG's motive for outsourcing.

5.5.7 CAC noted that while outsourcing is not necessarily inappropriate, when outsourcing to affiliates is the norm, it raises questions about whether ratepayer interests are being compromised to benefit the shareholder.

5.5.8 CAC and IGUA both argued that ECG has provided no evidence to demonstrate that these arrangements provide benefits to ratepayers. No studies were produced to demonstrate that the provision of these services by EI or other affiliates was superior to providing them within the utility.

5.5.9 ECG stated that there is "no evidence that outsourcing will harm ratepayers. In fact, the evidence in this proceeding is that costs will be reduced, service quality will be enhanced and ratepayers will benefit as a result of ECG's decision to outsource Gas Services and Operational Services to EI and EOS respectively".

System Reliability and Quality of Service

5.5.10 ECG argued that in the Decision on the Motion the Board stated that "[u]tility customers should be indifferent as to whether...services [customer care, information technology and fleet management] are performed within the utility by utility employees, or by a third party affiliate, as long as they are performed to the requisite standard". ECG argued that there has been no suggestion that ECG's outsourcing arrangements have adversely affected the quality of service that ECG provides to its customers. The service quality indicators of the TPBR Plan ensure that service levels are maintained.

5.5.11 ECG argued that there is a "significant benefit to ratepayers", from not only a cost but also from a service quality perspective, in locating the Gas Service functions in the business centre of the western Canadian supply basin.

5.5.12 CAC noted that ECG did not provide any credible evidence to support the claims of "system reliability", "security of supply" and to "maximize operating efficiencies". CAC questioned how security of supply and reliability can be enhanced and maintained by moving key operational functions for an Ontario-based LDC to Alberta.

5.5.13 Schools viewed ECG's alleged difficulty in obtaining qualified personnel in Ontario as "incredulous, given the large number of gas marketing and trading companies with offices in the Toronto area. Some of the more skillful gas traders in Canada reside in the Toronto area. Even if the Company's claim were true, the Company has not explained why it could not simply plan and hire some ECG employees in a Calgary office, much as it did several years ago..."

Economies of Scale and Scope

5.5.14 ECG argued that it was prohibited from achieving the same degree of synergies and efficiencies that could be achieved by EOS by consolidating the gas and liquids control functions. ECG argued that "Put in the simplest of terms, hypothetically speaking, if EOS can provide services more cheaply than ECG because of economies of scale and scope than are available to ECG should not such costs efficiencies accrue to EOS? Clearly the answer is "yes".

5.5.15 HVAC's response to this question was "clearly no". HVAC argued that in a competitive market, where EOS would not have a utility with captive customers, the efficiencies realized by EOS would be shared, and monopoly rents that either elevate shareholder returns or provide the opportunity to allocate all efficiency gains elsewhere would be precluded, and that the Board must return to its essential mandate to act as a proxy for competition.

5.5.16 ECG admitted that one of the reasons for the joint venture was that ECS had excess "capability".

5.5.17 Schools argued that the formation of the joint venture should have lowered the overall unit costs of the entity which should have resulted in savings for both ECS and BC Gas, part of which could have been passed through to ECG and its ratepayers. Schools also noted that the British Columbia Utilities Commission ("BCUC") referred to BC Gas stating that the "fees paid by ECG for similar services are higher than those to be paid by BC Gas. It is not clear why."

Maximizing Profit to the Shareholder

5.5.18 Schools noted that EGC's prefiled evidence contained only a brief description of the affiliate outsourcing arrangements and that there was no rationale or explanation as to why they would be in the interests of the utility or its ratepayers. It was not until ECG produced, on cross examination at the oral hearing, presentations to ECG's and Enbridge's executive committees that light was cast on the decisions including:

- that the creation of the gas purchase function in EI was to be the first step of a multi-stage process, the second phase of which would be to transfer the storage assets and business of the utility either to EI or to a separate storage company;
- that the return on equity in the gas storage/transactional services company, was estimated at 26% compared with the utility return of 9.7%;
- that the creation of a gas service division in EI would assist EI in solving its "problem" of selling its transportation capacity on the Alliance/Vector pipeline systems and/or buying gas to sell to customers, potentially including ECG, which would be transported through one or both of those pipelines;
- the alleged difficulty of obtaining qualified personnel in Ontario;
- the fear that in the future the Board would insist on competitive bids for the gas supply function;
- that ECG did not want an unaffiliated third party to provide the services since it would be "giving away" its expertise; and
- the alleged threat of the Board's disallowance of gas costs.

5.5.19 IGUA made much the same argument as Schools, that the primary objective of ECG's plans to gradually transfer the performance of critical utility functions to affiliates was to substantially enhance returns to ECG's shareholder and ultimate parent EI. IGUA also argued that the documents strongly indicate that one of the objectives of the arrangements is to divert transactional services revenue from ECG to EI, and that an objective of the overall plan was to establish an organizational structure whereby utility information would be provided to and utility functions would be performed by an entity within the Enbridge Group which was also authorized to participate on its own account in the competitive market.

5.5.20 Schools argued that these inter-affiliate arrangements are reallocations of business functions to various entities within the group in a manner which maximizes the profitability of the Enbridge Group as a whole, but which do not necessarily serve the best interests of the utility and its ratepayers. In Schools' view, ECG bears a heavy onus to demonstrate that such arrangements provide benefits to the ratepayers at least equivalent to those provided to the Enbridge Group shareholders.

5.6 POTENTIAL CONSEQUENCES OF OUTSOURCING

Conflict of Interest

5.6.1 ECG did not see the need for the Board to restrict or otherwise condition ECG's ability to outsource utility functions to affiliates, because the outsourcing arrangements do or will contain provisions or protocols that prevent the only conflicts of interest that ECG sees arising from the outsourcing arrangements. ECG did not think access to utility information of the type given by ECG to EI and EOS,

or by them to one another, could impair competition even if either affiliate were active in Ontario gas markets.

5.6.2 ECG claimed that the only services in which EI could have a conflict of interest were buying gas for ECG as ECG's agent from itself as a principal, or selling a transactional service for ECG as ECG's agent to itself as a principal.

5.6.3 ECG argued that EI, as ECG's agent has an equitable duty to ECG to act in the best interests of ECG. ECG pointed out that EI is contractually obligated, under the Agency Agreement, to "act honestly and in good faith with a view to the best interests of [ECG]" and to "exercise that degree of care, diligence and skill that a prudent and reasonable service provider could exercise in providing the Services in comparable circumstances". ECG argued that to suggest that EI would breach its equitable and contractual duties in this regard is, "quite simply to imply bad faith on the part of EI".

5.6.4 HVAC countered ECG's argument with the following:

- it is not self evident that a "reasonable service provider" would not, and should not, prefer its own interests over that of one of its customers, or the interests of one customer over another, in the event that a choice was required;
- if the argument is taken to its logical conclusion the Board should never have to exercise its mandate, since by extension ECG's argument would entail positing that review by the Board of ECG's costs and rate-making policies implies that ECG is not acting in the best interests of it customers (the ratepayers). HVAC submitted that the Board does not have to suspect *mala*

fides on the part of ECG or EI, in order to justify oversight of the utility functions.

- EI's management is obligated, as a matter of law, to protect EI's interests even at the expense of the interests of its customer ECG. That is why the ARC exists and is why the Board might conclude that its intervention into these outsourcing arrangements is warranted.

5.6.5 Some of the Intervenors claimed that EI has a conflict of interest when EI is engaged in its own transactions regardless of whether ECG is EI's counterparty. EI is in a position to prefer its own commercial interests over ECG's interests, in terms of transactional services, and to use its access to utility assets and information to compete against other participants in the gas trading and sales business.

5.6.6 CAC did not accept ECG's proposition that the agency agreements, protocols negotiated within the EI family between affiliates, existing Codes and the Board's rate-making powers provide sufficient protection for ratepayers.

5.6.7 Schools expressed concern that EI could reserve to itself the most attractive opportunities to acquire and trade gas, whether or not it uses the utility's assets in those transactions. In a rapidly changing commodity market, the best prices may only be available for a very short time. The Agency Agreement does not require EI to provide the opportunities first to ECG. EI declined to commit that it would not expand its gas wholesale business in the future.

5.6.8 Schools noted that EI holds transportation capacity on the Alliance/Vector pipelines. Normally it would assign that capacity to producers/marketers who require the capacity to move their gas; however, ECG witnesses professed that they did not know what EI would do with its gas.

5.6.9 Schools submitted that EI's dual role compromises the credibility and integrity of ECG's gas services business and will affect ECG's ability to obtain the best offers from the marketplace which will ultimately harm ratepayers.

Lack of Separation of Utility Functions and Competitive Services

5.6.10 CEED pointed out that since at least 1997, the Board has insisted upon the separation of utility and competitive services "so that information available in the provision of utility services could not be used in the provision of competitive services". CEED argued that ECG has resisted this direction and has maintained the position that it should be able to provide competitive services.

5.6.11 CEED argued that in this case, ECG is trying to bring about the same result through different means. Instead of providing competitive services in the utility, it proposes providing utility services through a competitive affiliate. The result is the same because in either case, the same corporate entity is providing both competitive and utility services. The harm is the same, because the competitive corporate entity has access to information available in the provision of utility services.

5.6.12 IGUA submitted that the principles that have guided the development of the provisions of the Undertakings, the Act and the ARC have been expressed in many previous Board decisions and reports relating to the operation of the regulated natural gas transmission, distribution and storage businesses in the competitive gas commodity market and include the following:

- the performance of utility functions is to be physically, functionally and organizationally separated from the competitive market business activities;
- there shall be no preferences conferred on utility affiliates engaged in competitive market business activities through preferential access to utility resources or information, confidential or otherwise; and
- utility ratepayers shall not subsidize affiliates engaged in competitive market business activities.

5.6.13 IGUA questioned whether the agency arrangement between ECG and EI in which ECG specifically agrees that EI can participate as a principal on its own account in the competitive marketplace while performing critical utility functions for ECG as ECG's agent, contravenes these guiding principles. IGUA argued that it appears to be ECG's position that if the legal responsibility for the performance of utility functions rests with two different corporations, then the principle requiring functional and corporate separation of the performance of monopoly and competitive market business activities is not contravened despite the fact that the functions are actually being performed by one company.

Access to Confidential Information

5.6.14 A number of Intervenors expressed concern that confidential information provided by ECG to EI may be used by EI when acting as principal for its own account, and in competition with other parties who would not have the same information.

5.6.15 ECG advised the Board that ECG, EI, and EOS are working on amendments to the two outsourcing arrangements in order to harmonize them. The amendments will provide for the sharing of ECG's information by EOS and EI so that they each have the information, from one another as well as from ECG, that they each need to provide their respective services to ECG.

5.6.16 ECG admitted that much of the information about storage balances, supply demand balances in the commodity and storage services and other aggregate data which it provides to EI is not available to gas marketers and trading entities at large.

5.6.17 ECG argued that:

- its witnesses could not envision a single, real-life example of a situation where the information that is provided to EI would give EI a competitive advantage;
- the Agency Agreement sets out, very specifically, the provisions that pertain to the treatment of confidential information;
- the Agency Agreement obliges EI to do such things as are necessary to assist [ECG] to comply with the ARC;
- much of the information provided to EI was for the purpose of gas supply planning, rather than gas acquisitions; and

- much of the customer information that was provided to EI was either not confidential or was sufficiently aggregated that any individual customer's or marketer's information could not be identified.

5.6.18 HVAC argued that the aggregate or generic information provided by EI to ECG, when not available to anyone else, is as much a competitive advantage as would be the identity of particular customers and their particular service needs. Access to this information, combined with the absence of restraints on its use by EI in the agreement between EI and ECG will provide a competitive advantage to EI should it choose to enter these markets. In Schools' view, ratepayers benefit more from a competitive market for wholesale services which has a level playing field.

5.6.19 HVAC noted that s.2.2.5 of the Board's *Standard Supply Service Code for Electricity Distributors* contains a limitation on the permitted business scope of an electricity retailer who provides standard supply service on behalf of an electricity distributor, in addition to an express limitation on the use that such a third party supplier is permitted to make of consumer-specific information obtained by it in the course of providing standard supply service. HVAC urged that a similar restriction should be required of EI in respect of the outsourcing reviewed in this case.

5.6.20 HVAC submitted that the issue is not whether EI has access to "confidential" utility information; but rather whether EI has access to utility information, that is, information possessed by the utility by virtue of, and as a result of, carrying out its obligations under its monopoly franchise, that other parties do not have ready access to. If EI does have access to such utility information it has a potential competitive advantage by virtue of its dealings with the utility. Such advantages have traditionally been subject to control by monopoly regulators.

5.6.21 While ECG claimed that it appreciated the concerns of intervenors regarding the use of customer and utility information by its affiliates, ECG did not accept that the outsourcing arrangements offend the ARC, the Undertakings, or the policy intent of the government of Ontario in this regard. ECG denied, "in the strongest possible terms" that its outsourcing arrangements were intended as a vehicle to give a competitive advantage to EI to the detriment of its competitors. ECG submitted that the Customer and Utility Information EI receives from ECG and EOS does not, and cannot, advantage EI.

5.6.22 In order to illustrate ECG's "probity", ECG indicated that it is prepared to undertake that, on or before October 1st, (2002) all Customer Information that is provided to EI, either directly or indirectly (through EOS) will be provided in a form that is sufficiently aggregated such that any individual consumer's, marketer's or other utility service customer's information cannot reasonably be identified. ECG is also prepared to undertake that the Customer Information that is provided to EI will also be provided, on requests and on a non-discriminatory basis, to individual customers or their agents in the same format that the information is provided to EI.

Lack of Independence

5.6.23 Schools suggested that having the parent conduct critical business functions creates several problems:

- it makes it more difficult for the Board to properly regulate these utility services; the Company has suggested that EI personnel and documents may not be available to the Board and intervenors;

- the utility will lose its ability to operate on a stand-alone and independent basis and will be more vulnerable to the influence of the owner over a whole host of issues;
- the utility will depend upon the good will and contractual undertakings of its owner, whose interests may vary from those of the utility. At the very least the owner will have competing interests such as maximizing the return on capital of its unregulated business;
- EI's financial interests are not identical to those of the utility. Schools notes that ECG's Standard& Poors debt ratings have recently been lowered, due in part, to the reduction of the ratings of EI's debt, as a result of EI's numerous acquisitions over the last two years;
- the utility will be providing expertise for which it is not being paid, to help the owner to solve one of its "problems", namely its need to manage its exposure to Alliance/Vector demand charges and in aid thereof, to purchase gas in Alberta for delivery through those pipelines; and
- the owner EI, has placed itself in a clear conflict of interest position by retaining the right to carry on the same businesses in its own right that it is to conduct on behalf of ECG.

5.6.24 Schools noted that there has been a tendency in recent years for gas utilities to become part of very large energy companies and this emphasizes the need for close examination of any such arrangements. Schools noted that ECG's witness, Mr. Pleckaitis, focused his testimony on EI being able to compete internationally. Schools stated while the "nexus between the issues at hand and international competitiveness is not altogether clear, the perspective, at least, is revealing. The interests of the individual parts of the EI organization, including ECG, are now subordinate to the interests of the larger entity, for better or for worse".

5.6.25 Schools also pointed out that "EI is the owner of ECG. ECG senior personnel report to EI personnel, and presumably some ECG executives aspire to one day being executives of the parent company. None of this bodes well for independence of action of the utility"

Loss of Regulatory Oversight

5.6.26 A number of Intervenors expressed concern that the Board may lose regulatory oversight of utility functions when a utility no longer performs them.

5.6.27 ECG argued that the Board's regulatory oversight is not affected by ECG's outsourcing arrangement to its affiliates, any more than it has been affected by many of ECG's outsourcing to non-affiliated third parties in the past. ECG submitted that Gas Services, Operational Services and customer care services will continue to be subject to the Board's scrutiny, pursuant to the provisions of the Act, as they have in the past. ECG will be responsible for providing the Board with the information it requires to carry out its responsibilities under the Act and the ARC. The Board will continue to exercise its regulatory jurisdiction over ECG and ECG will continue to attorn to such jurisdiction. In the meantime ECG's management should be free to organize its business as it sees fit, provided that ratepayers are held harmless.

5.6.28 HVAC pointed out that ECG argues that, quite apart from whether the Board has the jurisdiction to exercise oversight in respect of these arrangements, it need not, since the subject contracts provide ample ratepayer and market protection. HVAC concluded that regulatory intervention cannot be supplanted by the contractual terms

relied on by ECG. Those terms do not address the concerns raised regarding the outsourcing arrangements.

5.6.29 CAC submitted that although ECG is claiming that the outsourcing of these functions to EI and EOS was undertaken largely to achieve cost efficiencies and improve service quality, CAC is of the view that these initiatives were undertaken as part of a larger strategy to benefit EI and in an attempt to do so reduce regulatory oversight of utility functions.

5.6.30 Schools submitted that the Board should regulate ECG's outsourcing activities to ensure the Board can properly regulate the conduct of the monopoly utility business in the future.

5.6.31 CME submitted that while ECG takes the position that "the Board cannot seek to extend its jurisdiction indirectly, through ECG, to companies over which it has no jurisdiction, other than under a rule made pursuant to clause 44(1)(g) of the Act, CME submitted that likewise, ECG cannot avoid the jurisdiction of the Board by transferring functions, particularly Gas Services, to another entity. The Board has a broad mandate under the Act, and arguably has the ability to ensure that a franchisee fulfills its legal obligations, particularly when the entity that the functions have been outsourced to is an affiliate of the utility. To decide otherwise would enable ECG to escape the regulatory framework that the province has set out for utilities, such as ECG by simply outsourcing most functions.

5.7 SPECIFIC CONCERNS OF ECG'S OUTSOURCING ARRANGEMENTS

Contractual Provisions and Protocols

5.7.1 ECG advised the Board that the agreements contain a number of provisions to protect ratepayers, such as the Protocols and that ECG has a duty to its ratepayers to ensure compliance with the Protocols and, if necessary, to take appropriate action.

5.7.2 In Schools' view the contracts that underpin the affiliate transactions do not adequately protect the interests of ECG and its ratepayers for a number of reasons.

5.7.3 Some of Schools' noted a number of specific concerns about the Client Services Agreement between ECG and CustomerWorks.

- The agreement contains a right of first refusal, which provides that at the end of the term of the agreement ECG has the right to tender, but CWLP has the right to match any offer. This deters other parties from bidding and confers a significant benefit on the original service provider. As a practical matter CWLP is "virtually guaranteed" repeated extensions of this contract beyond the initial five year term. Schools pointed out that the BCUC was highly critical of a similar feature in BC Gas's contract with CWLP and suggested having truly competitive bids at the expiration of the contract regardless of the contract.
- CWLP does not have a strong incentive to perform at the highest possible level under the contract. The fees payable to CWLP by ECG are either a flat fee per month or a flat fee per transaction, and CustomerWorks is not obliged to reduce its charges to ECG if it develops better processes, deploys new technologies or has economies of scale.

- While the agreement provides some obligation on CustomerWorks to bring forward for consideration anything it might find out which could increase efficiency or improve service, that obligation is limited to "reasonable commercial efforts", a standard that, in Schools' opinion "admits much judgment".
- ECG does not have formal responsibilities under the agreement to continue to examine opportunities to reduce costs or enhance service levels and to bring these to the attention of CustomerWorks.
- The agreement does not contain a definition of "material default", except to exclude from its ambit failure to meet the performance requirements and time frames included in the schedules to the agreement. Schools questioned that if failure to meet performance standards is not a material default, what is?

5.7.4 Schools pointed out that BC Gas's contract with CustomerWorks has the same right of first refusal but with some protection for ratepayers through a requirement that in the event BC Gas decides not to tender at the end of the term the rates for the services in any renewal year, CustomerWorks cannot increase over the previous year's rates by more than 50% of the rate of inflation. Events of default are also specified in the agreement.

5.7.5 Schools concluded that the lack of clear definition of when CustomerWorks is in default taken together with the right of first refusal shows that the agreement is not a true arm's length agreement, but rather "was structured to advance and protect the interests of the service provider CustomerWorks at the expense of the utility and its ratepayers."

5.7.6 Schools noted a number of deficiencies in the Intercorporate Services Agreement and Agency Agreement with EOS:

- EOS is a start-up company and neither its obligations nor its financial viability are guaranteed by EI or any substantive entity in the Enbridge Group.
- EOS is conducting a function indispensable to the safe and secure operation of the utility however, there is no financial information available to the Board on EOS.
- Although there is an obligation to make available to ECG terms equal to those subsequently agreed to in a contract with any other affiliate of EOS, that right does not extend to terms offered to unaffiliated third parties.
- There are no performance standards set out in the agreement, and they are apparently still being worked on notwithstanding that the agreement is dated October 1, 2000 and that it requires the development of formal performance standards by July 31, 2001.
- There are no default provisions in the agreement and no remedies in the event of default, even if EOS is bankrupt or insolvent or fails to meet the yet-to-be developed performance standards.
- The Agency Agreement contains a price adjustment clause to the effect that if the Minster of National Revenue for Canada issues an assessment that would impose any liability for tax on the basis that the fair market value of the services is different than the amount charged and if the parties agree that the fair market value is different than the service charge, then the service charge shall be varied by the amount agreed upon by the parties. Schools pointed out that the parties are not required to change the service charge, if challenged by National Revenue, but may agree to continue to charge the price stipulated in the agreement.

- There is no price adjustment clause in the agreement. While there is a provision for parties to renegotiate pricing every two years to reflect "market pricing benchmarks" there is no indication of how one would go about determining what these are for an activity only carried out by distributors that are monopoly transporters of gas.

5.7.7 Schools expressed concern that the Master Agreement and Agency Agreement between ECG and EI contained many of the same weaknesses as the agreements between ECG and EOS, although Schools acknowledged that EI is a substantial entity. Schools expressly noted the following:

- The agreement places EI in a conflict of interest and the appearance thereof by permitting it to act in two capacities at once, as a contractor employed by ECG to provide it with various gas supply, planning and acquisition, transportation planning, storage planning, transaction services and contract management services, and as a provider of some or all of the same services to third parties. The agreement even permits EI to bid on some of the tenders that it is putting to the market on behalf of ECG.
- Since EI has no fiduciary obligation to ECG when it offers its own gas supply and transactional service businesses in the marketplace, it can take the better opportunities to itself, and ECG has no recourse.
- There are no performance standards set out, even though the contract went into effect on July 1, 2001. There are no default provisions and in the event of a dispute, the sole remedy is arbitration.
- The protocols, which the Company stressed were there to protect ratepayers, address only the situation where EI has been asked to tender to itself, for either gas supply or transactional service; they do not apply at all to the situation where EI takes the best opportunities for itself.

- There is no price adjustment clause in the contract.

5.7.8 Schools noted that the "protocols" do not address the issue of the nature of ECG's opportunity costs foregone, they only address the narrower issue of when EI is tendering services itself. Schools pointed out that EI can and may reserve to itself the most attractive opportunities as EI is not required to provide the opportunities first to ECG and that the Agency Agreement explicitly states that EI does not have a fiduciary obligation to ECG.

5.7.9 Some Intervenors expressed concern that no third party can enforce compliance with the contractual provisions and Protocols that pertain to a situation where EI acts as principal for its own account and is ECG's counterparty.

5.7.10 Some Intervenors also expressed concern that the Protocols would apply only to transactions in which ECG and EI are counterparties and that the Protocols are not yet available for review.

5.7.11 CAC questioned the extent to which these Protocols, negotiated between affiliates within the EI group of companies can ensure that ratepayer interests are not compromised in favour of shareholder interests. CAC also wondered what assurances there were that the protocols are complied with and how the Board could be satisfied that system supply is not negatively affected.

5.7.12 ECG responded that the Protocols protect ECG's ratepayers in a situation where EI acts as a principal for its own account and is a counterparty to ECG. ECG pointed out that EI is obligated under the Agency Agreement to comply with these Protocols.

Until these Protocols are in place, EI is precluded from acting as principal for its own account when ECG would be EI's counterparty.

5.7.13 Some Intervenors expressed concern that contractual provisions and Protocols could be amended at any time.

5.7.14 While ECG agreed that it may amend the outsourcing agreements, with the concurrence of its counterparty, ECG noted that "such amendments would be subject to the Board's scrutiny and direction but only to the extent that they were relevant to the exercise of the Board's regulatory jurisdiction under the Act or otherwise", for example compliance with the ARC.

5.7.15 Some of the Intervenors believed that the contractual provisions are not capable of adequately addressing their concerns about the outsourcing arrangements and, therefore, they believed that a Board order is necessary to impose appropriate terms and conditions to prevent conflicts of interests and other harm to customers.

Long Term Financial Viability

5.7.16 Schools pointed out that the Office of the Superintendent of Financial Institutions Canada ("OSFI") has set out Guidelines, Outsourcing of Business Functions by Federally Regulated Financial Institutions ("FRFIS"), dated January 2000 (the "Guidelines"). The Guidelines contain specific requirements with respect to the financial stability of any company to which a regulated institution may outsource a function critical to its operations. The Guidelines provide that outsourcing agreements must include audits of service providers, clear default procedures, remedies, sharing of gains and short falls, and incentives to reduce costs.

5.7.17 Schools noted that neither EI has guaranteed the performance or the financial viability of EOS or CustomerWorks and the Board has been provided with no information on the financial status of these corporations.

Effect on Incentive Regulation

5.7.18 Some Intervenors have concerns that ECG is outsourcing utility functions in advance of rebasing its revenue requirement for an incentive regulation plan

5.7.19 In Schools' view, ECG's outsourcing activities represents a major change in the way in which ECG conducted its regulated utility business up until that time. In Schools' submission, the transfer of customer care services in January 1, 2000 was a direct response to the commencement in October 1999 of the TPBR regime.

5.7.20 Schools argued that the real reason for the change is the savings opportunity provided by the PBR regime. For example, if ECG had retained the customer care function within the utility, any savings made through reduced staffing or improved processes or technology would, under a comprehensive PBR plan with an earnings sharing feature, be shared with ratepayers. On the other hand, where the function is outsourced pursuant to a contract such as the one between ECG and CustomerWorks that provides for a flat monthly rate or flat per transaction charges, any savings realized through more efficient operation or innovation accrue to the shareholder.

5.7.21 Schools argued that this is counter to the intent of performance based rate-making plans, which are to incent the utility to try to reduce its costs by operating more efficiently, to try harder to discover and implement process improvements and technical innovations which lower its costs of doing business, and/or to offer new and better services.

5.7.22 Schools argued that the proponents of PBR did not envisage that the utilities and their parent companies would transfer functions to unregulated affiliates pursuant to long term fixed price contracts where the contract prices would not be reduced during the term of the PBR, or at rebasing, to reflect cost savings realized by the unregulated service provider, and where savings can be hidden by the unregulated affiliates' refusal to disclose costs and revenues.

5.7.23 Even if the Board accepts the propriety of outsourcing a particular business function, and there are precautions taken against the export of savings, Schools argued that the Board must ensure, particularly in the case where the party performing the business function is an affiliate, that the process by which the contracts were awarded and the specific contractual arrangements under which the utility purchases services from the affiliate are fair to utility ratepayers and comply with the letter and the spirit of the *Affiliate Relationships Code for Gas Utilities* (the "ARC" or the "Code").

5.7.24 Schools argued that large scale outsourcing to affiliates in the context of a PBR plan (whether price cap, revenue cap, or otherwise) can lead to "the export of savings", that is, the realization of PBR driven O&M savings and additional revenues in unregulated affiliates, which savings then accrue to the shareholder alone, rather than in the regulated utility, where traditionally the savings are shared with ratepayers pursuant to earnings-sharing arrangements.

5.7.25 IGUA pointed out that the outsourcing arrangements do not transparently reveal the extent to which EI's returns are increasing as a result of "savings" achieved through outsourcing.

5.8 TRANSFER PRICING

5.8.1 Paragraphs 2.3.2 and 2.3.3 of the ARC provide:

> 2.3.2 In purchasing service, resource or product from an affiliate, a utility shall pay no more than the fair market value. For the purpose of purchasing a service, resource or product a valid tendering process shall be evidence of fair market value.
>
> 2.3.3 Where a fair market value is not available for any product, resource or service, utilities shall charge no less than a cost based price, and shall pay no more than a cost based price. A cost based price shall reflect the costs of producing the service or product, including a return on invested capital. The return component shall be the higher of the utility's approved rate of return or the bank prime rate.

5.8.2 ECG argued that issues regarding the proper methods of determining transfer prices and the recovery of such costs are not for this proceeding.

5.8.3 ECG advised the Board it endeavours to establish market prices for all affiliate transactions. Where there is a viable market for comparable services, ECG uses a number of sources of information in order to validate pricing, "including but not limited to articles and reports, consultants' reports, past experience, and tendering" In some cases, due to the nature of the service, it is not possible to establish a comparable market price. For such services, ECG established cost based prices

relying on its historic internal costs. ECG argued that since is uses market based prices where available and costs based prices where a market price cannot be determined, ECG is in compliance with the transfer pricing provisions of the ARC.

5.8.4 At the oral hearing ECG provided the following chart to demonstrate its basis for determining the proper transfer pricing:

Service Provider	Service	Transfer Pricing Basis
ECS	Desktop Support	Market
ECS	Network & Telecommunications	Market
ECS	Application Maintenance	Market
ECS	Document Reproduction	Market
ECS	Fleet & Equipment	Market
ECS	Asset & Revenue Protection	Cost
ECS	Labour Relations	Cost
ECS	Learning & Leadership	Cost
ECS	Employee Communications	Cost
ECS	Consulting & Professional IT	Market
EI	Audit	Market
EI	Tax	Market
EI	Risk Management	Cost
EI	Supplier Management	Cost
EI	Government Relations	Cost
EI	Management Fee	Cost
EI	Treasury Fee	Cost

CWLP	Call Centre	Market & Cost
CWLP	Credit and Collections	Market & Cost
CWLP	Meter Reading	Market & Cost
CWLP	Billing Support Services	Market & Cost
EI	Gas Supply Management	Cost
EI	Gas Control & Nominations	Cost

5.8.5 Union submitted that the cost based price referred to in this paragraph is the utility's cost base, not the affiliates', for the following three reasons:

- the Board has no jurisdiction over an affiliate or what it can charge for goods and services;
- the language of the ARC does not extend to the affiliates' costs; and
- the contrary interpretation would effectively prohibit affiliate transactions altogether.

5.8.6 Union argued that as a statutory tribunal the Board has only the powers and jurisdiction conferred on it by statue and that rules made under the Board's rule-making powers cannot expand the Board's statutory jurisdiction. Such rules may only enhance the effectiveness of the exercise of the powers the Board already has, not add to those powers. *Ainsley Financial Corp. v. Ontario (Securities Commission)* (1994) O.R (3rd) 104 (C.A.).

5.8.7 Union argued that the Board's only relevant source of jurisdiction over what a corporation can charge for products and services in Ontario is section 36 of the Act - the power to make orders approving of fixing just and reasonable rates for the sale of gas and for the transmission, distribution and storage of gas. That authority extends only to gas transmitters, gas distributors and storage companies. It is in

regard to those entities and those entities alone that the Board may make orders approving or fixing just and reasonable rates. If an affiliate is not selling, transmitting, distributing or storing gas, the Board has no jurisdiction over that affiliate.

5.8.8 Union argued that the power to add conditions to the Board's order found in section 36(4) of the Act is restricted to conditions relating to an order approving the rates charged by a gas transmitter, gas distributor or storage company. Union argued that the Board has no authority to determine what an affiliate may charge for a product or service to a utility in Ontario. The Board's only jurisdiction is to determine whether the recovery of the utility's cost of that product or service in rates is just and reasonable. Union argued that to the extent that the language of the ARC seeks to go beyond that, it is *ultra vires*.

5.8.9 Union also argued that the words of the ARC should be read so as not to extend the term "cost based price" to the costs of the affiliate, but rather, should apply only to the costs of the utility. The affiliate is not, by definition, regulated. Its costs are not relevant to any issue. The purpose of the ARC is to ensure that, if there is no market value for a product or service, the ratepayer pays no more than the utility's cost - in other words, to ensure that the ratepayer is held harmless in any affiliate transaction. In Union's view, the reference to the utility's approved rate of return emphasizes this point. The utility's regulated rate of return is utterly irrelevant to the operational parameters, pricing, business plans and operations or hurdle rate for investment of the affiliate. Reference to the utility's rate of return therefore has nothing to do with the affiliate.

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5.8.10 Union submitted that under cost of service regulation, the Board has never based its assessment of utility costs on the costs of the parent or shareholder. For example, the utility's cost of capital has always been assessed on a stand alone basis. The effect of the parent's credit worthiness or perceived investment risk , positive or negative, on the utility's cost of capital has never been incorporated as part of the utility's recoverable cost.

5.8.11 Union suggested that pricing outsourced services on the basis of the affiliate's costs would also create a serious mismatch between risk and return for the affiliate. An affiliate may have a totally different risk profile from the utility, yet, under this interpretation of the ARC, it would receive only the utility rate of return. This mismatch cannot have been contemplated when the ARC was put in place. Cost based price, therefore, must mean utility cost plus utility return or affiliate cost plus affiliate return and cannot mean affiliate cost and utility return.

5.8.12 Union further argued that if the Board interprets paragraph 2.2.3 of the ARC to mean that the costs of the affiliate (plus the utility return on capital) is the relevant cost for determining a cost based price:

- there would be no benefit to a distribution utility being part of a larger corporate group; and
- ratepayers would be denied any benefits of economies of scale, etc. that can be achieved through association with a larger corporate group, in the form of avoided escalating utility costs to provide that services.

5.8.13 If "cost based price" means the affiliate cost then the Board would effectively be "expropriating" from the affiliate all of the benefits of infrastructure efficiencies and economies of scale that the affiliate brings to the table. If this were the result, no affiliate would offer these services to a regulated distribution company. Thus, the utility would be obliged, unlike most other businesses, to continue to operate on a stand alone basis, providing for itself all necessary services, with limited or no opportunity to take advantage of efficiencies of scope or scale. This would have the effect of disqualifying the utility industry from participating in business arrangements used commonly by unregulated businesses to derive efficiencies and enhance value to shareholders. It would be saying to utility owners or potential owners than any economies of scale achievable for a utility company as a result of its affiliates' size and scope would be "appropriated" to the utility's ratepayers. Union asserted that "No owner would offer services to the utility on those terms".

5.8.14 Union continued that "the Board is well aware that premiums over book value are frequently paid for utility companies or their owners. One of the reasons for these premiums is the "market expectation" that further efficiencies can be derived from economies of scale and scope (i.e. consolidation/ affiliate outsourcing). The Board has always been careful to recognize that both the risk and reward associated with these premiums are for the shareholders' account, not the ratepayers'. If all savings resulting from economies of scale must be passed on to ratepayers, the Board might reasonably be concerned about the implication this would have for utility ownership. Large, efficient, well-financed corporate groups would look elsewhere for investment. Utilities will be owned and operated by smaller, perhaps riskier and less well financed entities as stand alone entities, with little or no prospect for innovation and benefit to be derived from membership in a larger corporate undertaking."

5.8.15 Union pointed out that the reality is that utilities with the potential for significant savings are not likely to get valid bids for services even where a competitive market exists. This is because potential bidders will know that the tendering process is likely to represent nothing more than a price-setting or bench-marking exercise for services that will, ultimately, be provided by the affiliate in any event. As a practical matter, the utility and its affiliate may well have matter limited alternatives for pricing beyond section 2.2.3 of the ARC. An interpretation of this section that leads to the appropriation of all of the benefits of economies of scale and scope to the ratepayer is, therefore additionally punitive because of limited access to competitive quotes as a means of pricing services even where a competitive fair market value exists.

5.8.16 Union concluded that "[a]ppropriating all of the benefits of affiliate relationships to the ratepayer is tantamount to prohibiting outsourcing affiliate relationships altogether. Union does not believe this was the Board's intent in promulgating the ARC, nor was it within the Board's powers to do so. The Board's power is limited to making rules "governing the conduct" of a gas distributor in relation to its affiliates. These powers do not extend to prohibiting affiliate relationships altogether. The power to regulate does not include the power to prohibit, in this case, because the very concept of governing conduct as it relates to affiliates assume that here will be affiliate relationships.

5.8.17 CAC submitted that with respect to pricing, ECG simply claimed that because a market price is not available for these services the fees have been determined on the case of the fully allocated cost of ECG providing these services. CAC noted that the services were not publicly tendered. Because the fees are O&M expenses under the TPBR Plan, ECG has refused to disclose the level of fees or provide evidence to justify them. ECG's reluctance to provide the fee levels should give the Board

concern. Because these arrangements have been entered into during the term of the TPBR Plan, there has been no opportunity for the Board and intervenors to test whether or not the fee structures are consistent with the ARC. CAC noted that inappropriate pricing can, in effect, result in an overpayment by the utility to the affiliate. Full disclosure of the fees is the only way to ensure that cross-subsidization is not occurring.

5.8.18 HVAC also noted that ECG has highlighted the price adjustment clauses found in the various outsourcing agreements at issue. HVAC argued that those clauses provide that prices paid by the utility may be reset based on market comparators. These clauses do not, however, address those instances where market comparators are not available and utility fully allocated avoided costs have been used. Thus these clauses do not in fact address the real pricing concerns raised. If the costs incurred by EI and EOS in providing services to ECG are less than ECG's avoided costs, ratepayers benefits or "profits" will be lost.

5.8.19 HVAC noted that this is the first time that ECG has made it clear on the public record that the Company has interpreted the transfer pricing requirements of the ARC as allowing the utility to pay an affiliate service provider the equivalent of the utility's avoided costs, on a fully allocated basis, for outsourced services. Any efficiencies gained in the cost required to provide the outsourced functions accrues to the affiliate, or the shareholder, or perhaps another customer of the affiliate, but in any event not to the utility and thus its ratepayers.

5.8.20 HVAC noted that the other side of the concern regarding loss of ratepayer "profits" it that, to the extent that the affiliate, the common shareholder, or any customer of the affiliate operate competitive businesses, ECG ratepayers will be cross-subsidizing such competition. In the case of CWLP, ESI may pay CWLP less than ECG pays for the same billing services because the common service provider, CWLP, can recover a disproportionately higher share of its costs from the utility ratepayers, and therefore can afford to reduce prices in order to attract and retain other customers. In unregulated industries, this risk of the ability to extract monopoly rents is subject to oversight by the Federal Commissioner of Competition. In the Ontario natural gas industry, vigilance in respect of this risk falls under the purview of the Board, and , in particular, under the auspices of the ARC.

5.8.21 HVAC submitted that the proper interpretation of this provision is that the costs referred to as the requisite benchmark for a transfer price for procurement of a service by the utility from an affiliate are the costs of the affiliate to provide the service. ECG's interpretation, that the benchmark costs are those avoided by the utility in not having to undertake provision of the service internally, is unsustainable for the following reasons:

- if the Board had intended that in the case of procurement of a service by the utility from an affiliate the relevant costs were those avoided by the utility it could have easily drafted the rule this way;
- a plain reading of the rule indicates that it is the "costs to produce" the service, rather than the costs avoided in nor producing the service, that are apt; and
- only this interpretation renders the provision a "proxy for competition" (the general role of the regulator). If the affiliate transaction were subject to open competition, the pricing would be set at the level of the service provider's

> costs plus the required return in order to attract the capital necessary for the service to be provided. The costs that would be incurred by the service recipient to provide the functions internally might be relevant to the service recipient's decision about whether to self-provide or to procure the service, but would not be determinative of the price at which the service provider was willing to provide te service.

5.8.22 HVAC argued that ECG is in breach of the ARC's transfer pricing guidelines and the affiliate is, through the utility holding distribution ratepayers to "ransom".

5.8.23 Schools argued that the ARC strongly implies that any contract with affiliates should only be signed after a competitive bidding process, and secondly that if it is not possible to obtain competitive bids, and therefore genuine evidence of market prices for that business function or service, that a cost plus arrangement could be struck. The ARC does not contemplate methods other than competitive bids in determining market value because of the uncertainty and unreliability of such methods. The cost in question is the contractor's cost, with the contractor entitled to a return that is the higher of the utility's rate of return or the then current prime rate. Schools questioned how ECG can reconcile its view that the utility's avoided cost is what is being referred to in section 2.2.3 of the ARC with the alternative allowable rates of return.

5.8.24 Schools argued that section 2.3.2 of the ARC requires that a utility, in purchasing a service from an affiliate, pay no more than the fair market value. There is an obligation on the utility to make a determination of the fair market value for the service. The section continues: "For the purpose of purchasing a service, resource, or product, a valid tendering process shall be evidence of fair market value". Schools

argued that this section makes it clear that the fair market value shall be the price obtained in a competitive tender. The ARC does not contemplate that fair market value can be determined in any other manner. Schools argued that if it did, then the provision would read [... shall be the best evidence... of fair market value].

5.8.25 Therefore, Schools argued, unless the utility tenders, it must pay no more than a cost based price. Section 2.3.3 continues: " A cost based price shall reflect the cost of producing the service or product, including a return on invested capital. The return component shall be the higher of the utility's approved rate of return or the bank prime rate." Schools submitted that the costs referred to in section 2.3.3 of the ARC are the costs of the service provider. Schools noted that sections 2.8.2 and 2.8.3 of the ARC enable the Board to ask for a substantial amount of information concerning the affiliate costs.

5.8.26 In Schools' view ECG is in violation of the ARC in at least two respects:

- by transferring its gas services function to its affiliate and purchasing gas services pursuant to cost-based fee, in circumstances where alternative suppliers of the services exist, it is skirting the competitive tender rules. ECG wants to keep this function in the Enbridge family but in an unregulated affiliate, since it has developed valuable expertise. It can do this only by keeping the activity within the utility; and.
- the cost based standard that ECG purports to apply, the avoided cost of the utility if it were to continue to provide the service, is wrong, and would deny utility ratepayers a share of the benefits from any increases in efficiency of the service provider over time.

5.8.27 Schools concluded that if ECG's views were to prevail, then the utility would be able to completely frustrate the intent of the PBR regime by signing fixed price contracts with affiliates to provide large parts of the utility's functions. Any savings realized would not be passed on to customers, either during the term of the PBR, through sharing of the increased earnings that would flow from the decreased payments und the contract, or even at rebasing. The cost base would remain the utility's avoided cost", that is the current level of the contract payment, forever.

5.8.28 VECC argued that from the point of view of the ratepayers it represents, this transaction raises serious questions about value for money with respect to the fees paid by ECG for such services and the compliance with section 2.3.3 of the ARC.

5.8.29 VECC noted that these issues cannot be examined until ECG's 2003 rates application. It is, therefore incumbent upon ECG to file comprehensive, complete and timely information about the customer care arrangements and their value for money in ECG's 2003 rates application. VECC suggested that the Board should direct that CustomerWorks and Accenture personnel be available to the Board and prepared to testify to these matters during the proceeding.

5.8.30 IGUA pointed out that the new arrangements raise an issue of the manner in which the transfer pricing provisions of the ARC are to apply to an affiliate which has subcontracted to a third party. IGUA noted that ECG argued that to comply with the transfer pricing provisions of paragraph 2.3.3 of the ARC the amounts paid by ECG's ratepayers to CWLP should be limited to the amounts being paid by CWLP to Accenture's subsidiary. Any amounts being paid by Accenture's subsidiary to CWLP will include costs associated with Accenture's use of CWLP assets to provide the services. IGUA argued that any enhancements in return being realized as a result

of CWLP's arrangements with Accenture's subsidiary, effective August 1, 2002, must be accounted for in the utility, rather than in CWLP, in order for there to be compliance with the provisions of paragraph 2.3.3 of the ARC.

5.9 TRANSFER OF UTILITY FUNCTIONS

5.9.1 ECG contended that it can appoint its affiliate and ultimate parent to perform critical utility functions as its agent without leave of the Board.

5.9.2 IGUA pointed out that subsection 18(1) of the Act provides that:"No authority given by the Board under this or any other Act shall be transferred or assigned without leave of the Board."

5.9.3 IGUA argued that if the appointment of EI and EOS as ECG's agents to perform critical utility functions on behalf of ECG does not fall within the ambit of subsection 18(1) of the Act, then, in theory, regulated utilities would be able to eliminate the Board's regulatory oversight over those companies actually providing physical transmission, distribution and storage services by having them performed by unregulated agents. ECG and other regulated Ontario utilities would be able to reduce their staff levels to one contract administrator and the Board's regulatory power would be limited to either approving or disapproving the costs which the shell utility seeks to recover in rates. IGUA argued that ECG's contention that the Board's regulatory oversight is not affected by ECG's outsourcing arrangements is untenable.

5.9.4 IGUA submitted that the Agency Agreement whereby ECG confers authority on EI to provide Gas Services which are integral to the physical transmission, distribution and storage functions constitutes a transfer or assignment of ECG's authority to perform these functions as an enfranchised gas distributor pursuant to the *Public Utilities Act*, the *Municipal Franchises Act* and the Act and accordingly the Agency Agreement falls squarely within the ambit of subsection 18(1) of the Act.

5.9.5 IGUA further submitted that ECG's contract with EOS whereby EOS is retained as an independent contractor to provide Operational Services which are integral to the monopoly functions of physically transmitting, distributing and storing gas, is a contract which transfers or assigns ECG's authority to perform these functions and therefore it falls within the ambit of subsection 18(1) of the Act.

5.9.6 IGUA supplemented its submission in a letter dated July 24 2002 from its counsel to the Board Secretary. The letter referred to the Board's Decision with Reasons dated June 23, 2000 pertaining to an application by Union for a renewal of a franchise within the City of Kingston. IGUA stated that the issue in dispute in that case was the "ambit of the Board's power over the renewal of the 'right to operate' Union's gas distribution works". IGUA went on to argue that "it cannot reasonably be disputed" that the authority to obtain "the right to operate" transmission, distribution, and storage assets stems from the Board's power found in the Act with respect to leave to construct transmission and distribution lines and "other powers pertaining to storage assets".

5.9.7 Schools pointed out that subsection 18(1) of the Act requires the Board's approval to transfer a Board "authority" to do something from the party so authorized to another party. Schools argued, this requirement does not affect either the need for the Board's approval of rates and charges under section 36 of the Act nor its right to attach conditions to its order approving rates, or, as part of the order, prescribing practices relating to the distribution and sale of gas where appropriate. In Schools' view subsection 18(1) of the Act must remain subject to section 36 of the Act, which is the "jurisdictional heart of the Act". Moreover, in Schools' view, the fact that the party to whom the party which has received Board authority to do a certain act wishes to transfer that authority is an agent of the transferring party, does not remove the requirement for approval under section 18 of the Act.

5.9.8 Schools argued that although the agreement between EI and ECG is called an "Agency Agreement" EI is not an agent of ECG in law for several reasons.

- The degree of supervision to be exercised by ECG over EI is limited to broad oversight In several areas, in particular transactional services and gas acquisitions, ECG's oversight of EI's activities is not consistent with the degree to which an agent is normally supervised by its principal. EI has broad independence of action, within only very general guidelines to execute all transactional services transactions without referring them to ECG for approval. With respect to gas acquisitions EI may contract for gas supply up to $50 million per transaction, or any dollar amount provided the term is less than one year, without ECG's consent. ECG apparently plans to have only one employee oversee the totality of the gas services activities of EI, which means that such oversight will be general in nature.

- EI has the right to conduct its own business in the same areas in which it is acting on behalf of ECG , and has no duty to ECG higher than that of an independent contractor, in that regard.
- EI has no fiduciary obligation to ECG, the normal legal obligation, which every agent has to its principal.

5.9.9 Schools also pointed out that the agency relationship has no particular significance in the regulatory context. EI is a separate legal entity from ECG, but it is an unregulated entity, whereas ECG is a regulated utility. Even if EI is at law in some respects an agent of ECG that would not remove the need for Board approval for the transfer of any "authority" it had previously given to ECG. Schools argued that the Board's approval is required for ECG to transfer to EI the ability to use utility assets to conduct transactional issues.

5.9.10 ECG responded that the proposition that IGUA is advancing is unclear. In its main submission, IGUA argued that the Board "authority" that is transferred to EI and EOS under the outsourcing arrangements is the outsourcing agreements themselves; that is the Agency Agreement and the Intercorporate Services Agreement. The letter from its counsel appears to recant this argument in favour of a "novel" idea: that the "right to operate" gas transmission, distribution, and storage assets is granted by the Board pursuant to its powers to authorize the construction of pipelines and other unspecified powers pertaining to storage assets.

5.9.11 ECG took issue with IGUA's arguments regarding the applicability of subsection 18(1) for two reasons:

- the activities, comprising such services, are not activities that are authorized by the Board under the Act or any other legislation; and.

- even if such activities were authorized by the Board, the Intercorporate Services Agreement does not have the effect of transferring or assigning any authorization to EOS.

5.9.12 ECG pointed out that the Board does not have exclusive jurisdiction under the Act or any other legislation to regulate the construction and operation of distribution, storage and transmission facilities. The Legislative Assembly of Ontario has divided jurisdiction in this regard among the Board and the following other "regulators":

- the Board has jurisdiction under sections 90 and 91 of the Act to grant leave to construct hydrocarbon transmission lines and, only on an application, hydrocarbon distribution lines;
- the Board has jurisdiction under section 8 of the *Municipal Franchise Act* (the "MFA") to approve the construction of "any works to supply" gas within a particular municipality;
- municipal corporations have jurisdiction under the MFA and the *Public Utilities Act* to pass by-laws authorizing " any... person to construct operate any part of a ... public utility in the municipality" and in addition, authorizing any "company incorporated for the purpose of supplying any public utility" to "exercise any of its powers within the municipality";
- the Board must first approve the by-law "granting ... the right to construct or operate works for the distribution of gas" under section 9 of the MFA;
- the utility is required under the *Oil and Gas Pipelines Systems* O. Reg. 210/01, sections 5 and 6, promulgated pursuant to the *Technical Standards and Safety Authority, 2000* ("TSSA") to obtain not only a licence from the director under the TSSA before distributing or transmitting gas, but also a certificate before installing any pipeline;

- the Board has jurisdiction under sections 36.1 and 38 of the Act to designate an area as a gas storage area and similarly to authorize a person to "inject gas into, store gas in and remove gas from a designated storage area"; and
- the storage operator must obtain a licence from the director under the TSSA before storing gas.

5.9.13 ECG argued that in the result none of the activities carried out by EOS, on behalf of ECG, are activities authorized by the Board under the Act or any other legislation. The legislative scheme provides the Board with a shared jurisdiction to authorize the construction, but not the operation, or distribution and transmission facilities. It also provides the Board with a shared jurisdiction to authorize the construction and operation of storage facilities.

5.9.14 ECG further argued that quite apart from the fact that none of the activities comprising Operational Services are ones that are authorized by the Board (other than for rate-making purposes), there has been no transfer or assignment to EOS of ultimate authority over Operational Services. ECG argued that "ultimate accountability and responsibility for Operational Services remains with ECG". All operational services performed by EOS are performed on behalf of ECG. ECG retains the accountability and the responsibility for the operation of it distribution system. ECG claimed that ECG supervises EOS, "just as it supervises the work of other contractors and service providers that it employs".

5.9.15 ECG also took issue with IGUA's arguments regarding the applicability of subsection 18(1) to Gas Services provided under the Agency Agreement. ECG argued that all of the activities performed by EI on behalf of ECG, other than the storage-related Transactional Services (E.B.O. 190 Order), are not authorized by the

Board under the Act or any other legislation. ECG submitted that, even if these activities were authorized by the Board, the Agency Agreement does not have the effect of transferring or assigning any such authorization to EI. EI is ECG's agent, under the Agency Agreement, and as such performs all such activities on behalf of ECG by "standing in ECG's shoes".

5.9.16 ECG pointed out that EI does provide storage-related services on behalf of ECG, but only in the sense that transactional services include peak and off-peak storage. ECG noted that the term "authority" as it is found in subsection 18(1) of the Act, is not defined in the Act but, nevertheless, would be interpreted to include an order of the Board made under subsection 38(1) of the Act authorizing a person to engage in gas storage. However, while the transfer or assignment of functions to an affiliate that require the use of storage assets would require the Board's prior approval, under subsection 18(1), ECG argued that the Board's approval is not required "unless the transferee or assignee were acting as ECG's agent". For example, ECG pointed out that it has operated the storage assets of its affiliate Tecumseh Gas Storage Limited, without the requirement of Board approval.

5.10 REMEDIES AND JURISDICTION

5.10.1 ECG submitted that its outsourcing arrangements with affiliates continue to have absolutely no adverse effect on:

- the Board's regulatory oversight and its ability to carry out its responsibilities under the Act and the ARC;
- the security, safety, and reliability of ECG's distribution system;
- the costs and quality of customer services; or
- the competitive market for the sale of gas to users in Ontario.

5.10.2 Schools suggested that :

- the Board, as a condition of approval of ECG's 2002 rates, require that the business activities transferred to EI and EOS be repatriated to ECG within 6 months;
- the Board make it clear that in the future it will expect that prior to transferring utility business activities pursuant to multi-year contracts to third parties, affiliate or otherwise, the utility will obtain the Board's approval, in a preceding rate case, customer review process or specific application;
- the Board direct ECG to prepare a set of Outsourcing Guidelines, which should be filed as part of the evidence in the next rate case. In preparing the guidelines the Board should direct ECG to have regard to the OSFI Guidelines, as appropriate;
- the Board direct ECG to file as part of its 2003 rates case and as part of the rebasing exercise for the ECG's second generation PBR plan, in addition to the material it has already agreed to file, detailed information on the costs incurred by EI (gas services division) EOS, CustomerWorks and ECS, in providing services to ECG , under various agreements so that the Board and intervenors are able to determine a suitable baseline in respect of these utility business activities for the comprehensive PBR plan, and direct ECG to produce witnesses from these companies to answer questions relating to their costs and related matters in that case;
- that the Board clarify that the costs referred to in section 3.3 of the ARC are the costs of the unregulated affiliate, and that the test for purchases for an affiliate in the case where there was no competitive bids be the lower of "market based" price or costs of the affiliate including a return as set out by Dr. Bauer in his evidence in 497-01;

- that the Board clarify the intent of the ARC to be that competitive bids should be used in the outsourcing of business activities in all cases, and that only in the event that a successful tender cannot be completed can the utility arrange a transfer to a party on a "cost-plus basis"; and
- that in the event the Board decides not to order the repatriation of gas services business functions to ECG, that it condition its approval of ECG's 2002 rates on EI agreeing to exit the business of gas services for its own account and permit ECG if it deems such provision necessary to provide EI the specific assistance the latter requires with respect to the management of its transportation capacity and residual gas requirements for the Alliance/Vector systems.

5.10.3 Schools also requested that with respect to CustomerWorks, ECG and EI outsourcing agreements the Board as a condition of approval of 2002 rates:

- direct the Company to provide full affiliate costing data and related information in the 2003 rates case;
- direct ECG to remove the right of first refusal from the CustomerWorks Agreement as it is demonstrably not in the interests of ratepayers and is anti-competitive;
- direct ECG to file the performance standards for all three agreements - CustomerWorks, EI (gas services) and EOS (gas control) with the 2003 rates case;
- direct ECG to file any proposals for scope/fee changes for any of the agreements in a rates case or customer review for Board approval in advance of making the proposed change, including supporting evidence to show how the proposed changes will benefit ratepayers; and

- direct ECG to review the contracts to include clear default and remedy provisions and specific obligations on ECG to take all feasible steps to seek out improvements in service and/or fee reduction over time and a specific procedure for ensuring these measures are implemented.

5.10.4 CAC suggested that a comprehensive review of ECG's outsourcing by the Board is essential. The review is required as soon as possible given the fact that the storage application, the O&M rebasing proceeding and the likely introduction of comprehensive PBR are imminent. With respect to such a review, ECG's affiliates, to the extent they are performing utility functions, must be prepared to disclose any information relevant to the Board's consideration of these issues. They should be prepared to appear before the Board and present evidence on the same basis as the utility.

5.10.5 With respect to relief in this proceeding, CAC submitted that given ECG's reluctance to justify the fees it is currently paying to its affiliates, those fees should be held in a deferral account for future disposition. From CAC's perspective, the onus is on ECG to justify the arrangements it has with its affiliates, the basis for the fees and the extent to which they are consistent with the ARC. ECG has failed to provide adequate evidence in this regard.

5.10.6 CAC submitted that ECG should be require to present evidence in its next rate proceeding to demonstrate that its outsourcing arrangements:

- are not benefitting ECG's shareholder at the expense of its ratepayers;
- are not impairing competition in the Ontario natural gas market; and
- are not contrary to the public interest.

5.10.7 If ECG is unable to do so, CAC suggested that the arrangements should be prohibited or subject to specific conditions by the Board.

5.10.8 IGUA submitted that the new facts pertaining to the manner in which customer care services will be provided to ratepayers effective August 1, 2002 should influence the findings that the Board makes in its Decision With Reasons in this proceeding and the provisions of the order that is issued to conclude these proceedings as follows:

- the Board should find and state that by failing to disclose any information pertaining to ECG's role in the CWLP/ Accenture arrangements, during the evidentiary phase of these proceedings and in its written Argument-in Chief dated July 8, 2002 McGill and ECG breached the disclosure obligations which the Board took pains to articulate in its Decision on the Motion;
- the Board's order should contain provisions which will limit the amounts being paid by ECG to CWLP on and after August 1, 2002 to amounts being paid by CWLP to Accenture's subsidiary; and
- the Board should require ECG to file evidence in its fiscal 2003 rates application to demonstrate that its arrangements with CWLP have been adjusted to comply with the "service provider costs" approach specified in the provisions of paragraph 2.2.3 of the ARC.

5.10.9 HVAC disagreed with ECG's position that there is nothing that the Board should do in this proceeding, as the costs underpinning the service arrangements are captured within the utility's TPBR Plan. HVAC submitted that the Board does note need to wait until next year to correct this transgression. If a Board rule is being breached, the Board has the jurisdiction to require the cessation of the offending activity, including the right to levy fines for such breaches.

5.10.10 HVAC argued that in any event the Board should, in its decision, direct ECG that upon rebasing, the evidence in support of the cost of any procurement of goods or services from an affiliate are those of the affiliate. If sufficient evidence of those costs is not tendered and properly tested, the Board will be left in an untenable position. It will not have the evidence required to approve the utility O&M costs associated with these outsourcing arrangements. The Board should provide ECG with notice of its views on this issue now, to avoid being faced with the dilemma presented by ECG's likely argument that it is unreasonable to disallow all costs, and arbitrary to disallow a portion of them.

5.10.11 ECG submitted that the Board has limited jurisdiction over competition. This mandate is enunciated in section 2 of the Act as an objective of the Board to "facilitate competition in the sale of gas to users". ECG argued that this competition mandate is limited in three ways:

- section 2 refers to gas to "users" and by itself does not confer any powers on the Board and accordingly must be interpreted in the light of those sections of the Act that deal with such sales and that do confer powers; namely section 46-55 and pertain to gas marketing. ECG argued that the Board's competition objective pertains to competition in the sale of gas to "low-volume consumers" and thus is limited to jurisdiction to the retail gas market;
- section 2 refers only to the sale of gas to users. The section does not refer to "energy services", "competitive services", "competitive businesses", "competitive markets", competitive energy activities" or "competitive wholesale services" all of which CEED refers to in its argument.
- the Board's mandate is limited by the principle of territorial incompetence. A tribunal has no powers that its legislature does not have. A legislature may confer upon a tribunal only those powers that it may exercise itself.

> Accordingly a provincial tribunal, such as the Board does not have the power to make decisions regarding persons, activities, or things wholly outside the province.

5.10.12 ECG argued that the Board is restricted to exercising its powers under the Act in a manner that facilitates competition in the retail commodity market and then only in Ontario. ECG further argued that Intervenors, and particularly CEED, seek to have the Board exercise regulatory oversight over the wholesale markets and other energy services without regard to territorial limitations, which would, in ECG's view, be beyond the Board's express and implied jurisdiction.

5.10.13 ECG submitted that all of the Board's powers must be found in its enabling legislation. There are no powers in the Act that expressly allow the Board to prohibit outsourcing or to direct ECG to "repatriate" the outsourced services, amend the outsourcing agreements, or otherwise change the manner in which it has decided to manage its business. If the Board has the power to do this, if must be pursuant to the doctrine of jurisdiction by implication. In other words, such powers must be necessary and incidental to the exercise of one or more of the Board's express powers. The question of statutory interpretation is: did the legislature intend the Board to have a supervisory jurisdiction over and beyond its specific powers to issue orders for leave to construct and authorizing rates and storage services?

5.10.14 HVAC argued that the issue is whether the outsourcing by ECG has now reached the point where the Board must, in order to ensure the proper fulfillment by the franchisee of its legal obligations, condition any recovery of costs on certain outsourcing and/or reporting parameters, and thereby essentially direct certain basic organizational requirements.

5.10.15 In support of this position HVAC quoted the Board's decision in RP-1999-0058 where the Board stated:

> The Board acknowledged that ECG has the right to organize its financial affairs in an efficacious manner and to contract with ECS to perform customer care services, including billing and the operation of the call centre. However, the Board is not convinced by ECG's argument that because it has contracted with its affiliate, ECS to perform the customer care services, it is absolved of responsibility to comply with the ARC. This argument is particularly weak when the Board considers that ECG and ECS are affiliates, each controlled by the same parent, Enbridge Inc.

5.10.16 HVAC submitted that the same reasoning applies to ECG's responsibilities in respect of the basic obligations of its franchise. The Board retains the power to oversee the fulfillment of these obligations, regardless of where they may be outsourced to, and particularly where the entity to whom the functions have been outsourced, is an affiliate of the utility and controlled by the common parent.

5.10.17 ECG submitted that none of the provisions cited by the Intervenors expressly empower the Board to grant any of the relief sought by the Intervenors. ECG argued that the question is "whether these provisions confer the necessary power when taken together and viewed in the purposive sense, having regard to statutory objectives, the expertise of members of the Board and the nature of the issue".

5.10.18 ECG argued that:

- section 2 of the Act enumerates five natural gas objectives but confers no powers on the Board and the only objective relevant in this case is the facilitation of competition in the sale of gas to users;

- section 18(1) is not relevant for the reasons discussed elsewhere;
- subsection 19(2) that "[T]he Board ... shall make any determination in a proceeding by order" confers no jurisdiction and simply sets out the required form of any determination made by the Board; and
- while section 23 does confer a power to condition any order, where the Board seeks to condition an order under subsection 36(2) fixing rates the Board's general conditioning power in section 23 is circumscribed by its specific conditioning power under subsection 36(1) and consequently the Board cannot attach just any condition to a rate order; rather conditions must be applicable to the rate-making consequences of the sale, transmission, distribution or storage or gas, since there must be a reasonable nexus between the Board's power to condition a rate order issued under subsection 36(2) of the Act and the order so conditioned.

5.10.19 ECG argued that none of the conditions sought by the Intervenors in connection with the outsourcing of Gas Services can reasonably be related to the rate-making consequences of the " sale.. or storage of gas" within the meaning of subsection 36(4). ECG reiterated that EI purchases gas, as ECG's agent, but does not sell gas on behalf of ECG. ECG sells gas directly to its customers as a sales service. Similarly EI does not store gas on behalf of ECG; ECG stores its own gas. EI simply "optimizes" ECG's storage assets by providing transactional services, as agent, on behalf of ECG.

5.10.20 ECG further argued that none of the conditions sought by the Intervenors in connection with the outsourcing of Operational Services can be reasonably interpreted to be applicable to the rate-making consequences of the transmission or distribution of gas. There is no nexus between the Board's rate-making powers and

a condition that would compel ECG to repatriate Operational Services or amend the Intercorporate Services Agreement.

5.10.21 ECG compared the Board's jurisdiction under the Act with the broad powers of BCUC under the *Utilities Commission Act* (the "BCUC Act").

5.10.22 ECG argued that the Board's rate-making powers in respect of the sale, transmission, distribution, and storage of natural gas are set out in section 36 of the Act. The Board may make orders approving or fixing just and reasonable rates (subsection 36(2)) and in so doing may include "conditions, classifications or practices applicable to the sale, transmission, distribution or storage of gas, including rules respecting the calculation of rates" . The Board also has a general power when making an order to "impose such conditions as it considers proper". (section 23)

5.10.23 ECG argued that it is an accepted principle of statutory interpretation that general enactments should received general construction, unless the application of the relevant interpretative criteria gives some ground for restricting their meaning. Whenever there is a general enactment in a statute, which, if taken in its most comprehensive sense, would override a particular enactment in the same situation, the particular enactment must be operative, or in other words, " the particular ousts the general".

5.10.24 ECG argued that applying this principle to the question of the Board's power to condition an order made under subsection 36(2) leads the conclusion that the Board's general conditioning power under section 23 is circumscribed by its specific conditioning power under subsection 36(4). In other words the Board cannot attach

just any condition an order issued under subsection 36(2); and conditions must be "applicable to the sale, transmission, distribution or storage or gas".

5.10.25 ECG's position was that subsection 36(2) is not sufficiently broad to empower the Board to impose conditions in a rate order that would, in effect, compel or direct ECG's non-regulated affiliates in some fashion. "The Board cannot seek to extend its jurisdiction indirectly through ECG, to companies over which it has no such jurisdiction, other than under a rule made pursuant to clause 44(1)(g) of the Act. Clause 44(1)(g) is the only power that the Board has to compel or direct a gas distributor's affiliates.

5.10.26 ECG also argued that there is the practical difficulty of requiring ECG to compel or direct affiliates in circumstances where ECG has no power to do so. The contracts between ECG and its affiliates for the provision of services to ECG comprise ECG's only "levers" in this regard.

5.10.27 ECG argued that a power will not be implied unless there is a "jurisdictional foundation" to support such as power (ie an express power) and, moreover, there is a practical necessity to do so in order to accomplish the object of the legislation in question. A power will not be implied where the enabling legislation has prescribed an alternative mechanism for dealing with the matter at issue.

5.10.28 ECG argued that the applicable "jurisdictional foundation" is subsection 36(4) of the Act. Additional conditioning powers could only be implied if these were determined to be necessary to accomplish the legislative objective; in this case the setting of just and reasonable rates.

5.10.29 Union argued that while some intervenors have been quite explicit in advancing the position during the hearing that the Board should prohibit the outsourcing of so-called "core" utility functions, Union submitted that there is no jurisdictional basis upon which the Board could act on this argument. If an affiliate was operating as a gas distributor, transmitter or storage company in the province of Ontario, the Board would have the jurisdiction over it to approve or fix just and reasonable rates, adopting any method or technique the Board considered appropriate to do so. If the affiliate is not operating as a gas distributor, transmitter or storage company in the province of Ontario, however, the Board has no jurisdiction.

5.10.30 Union pointed out that the two major utilities in this province are privately-owned business corporations. They have management, including officers and directors, which is charged with the prudent management of the business and affairs of the corporation. It is management's job to organize and conduct the business affairs of the corporation. It is up to the Board to ensure that the prices the utility charges for gas distribution, transmission and storage services are just and reasonable.

5.10.31 Union takes a very narrow view of the Board's jurisdiction. Union argued that these are two very different roles and two very different responsibilities. Although they are not inconsistent and may very well lead to similar results, these responsibilities do not overlap. If an action by management results in an imprudently incurred cost, the Board has the opportunity to review that action and to determine whether the cost may be recovered in rates charged for the service. The Board does not have, however, the authority to take over the "reins of power" and direct how management should organize the business and affairs of the company. In support of this position, Union cites the British Columbia Court of Appeal decision in *British Columbia Hydro & Power Authority v. British Columbia (Utilities Commission)* (1996), 20.

B.C.L.R. 106 (B.C.C.A). The BCUC issued a document entitled "Integrated Resource Planning Guidelines" intended to provide guidance on the BCUC's expectations of the IRP planning process to be developed by BC Hydro. The BCUC denied recovery of BC Hydro's costs of planning in a subsequent rate application and ordered that BC Hydro comply with several directions relating to the integrated resource planning guidelines. The BC Court of Appeal overturned this decision, holding that the directions in the BCUC order relating to the integrated resource planning guidelines were beyond the statutory powers of the BCUC and were, accordingly unenforceable. In coming to this conclusion the BC Court of Appeal found that no section of the *Utilities Commission Act* enabled the BCUC to impose by order its chosen forum of IRP planning.

5.10.32 Union submitted that any attempt by the Board to order the manner in which a utility's affairs are planned and managed, including the decision to outsource certain business functions, would fall afoul of these principles and be outside the powers conferred on the Board by the Act. Union argued that the Board should limit its enquiry to the particular outsourcing agreements in issue in this case, and that it would be inappropriate and unnecessary for the Board to issue pronouncements about outsourcing or affiliate transactions generally.

5.10.33 Schools noted that the Board has broad jurisdiction over the distribution, transmission, storage, and sale of gas in Ontario. In Ontario, the Board's practice has been to allow the distribution utilities to "pass through" their gas costs, both commodity and the costs of upstream transportation to their customers "at cost" with no mark-up assuming that the costs were prudently incurred. The price of gas embedded in the sales rates is in the aggregate, equal to the utility's costs of gas.

5.10.34 In Schools' view this authority includes conditions and practices relating not only to the sale of gas, but also by necessary implication, to its procurement, including whether the gas can be purchased for the distributor by a third party affiliate, and any other matters critical to the efficient and effective purchase and distribution and sale (by the distributor) of gas. In addition, as the cost of gas is part of the bundled distribution rate, the Board can condition its approval of distribution rates upon the distributor retaining the gas services function.

5.10.35 Schools argued that the Board may condition its orders approving distribution rates by conditions relating to the method of distribution, including whether the gas control, scheduling and nomination functions, which are critical to the efficient and safe operation of a distribution system, need to be carried out by the distributor itself, or can be carried out by a third party, affiliated or otherwise.

5.10.36 Schools further argued that the same provisions authorize the Board to set rules with respect to the ability of the distributor to contract with a third party, affiliated or otherwise, to provide any activity or business function normally performed by a distributor. The business activities of gas procurement, gas control, and customer care are clearly part of the distributor's normal business. Section 35(4) permits the Board to prescribe practices applicable to the distribution of gas. One such practice is the degree to which and the manner in which the distributor can contract with third parties to carry out business activities on its behalf.

5.10.37 Schools submitted that the Board's interest in the degree to which the distributor can transfer business activities to third parties, including affiliates, is clear. It derives not only from the cost implications of the transfer but from the decisions on the integrity, safety and security of the distributor's business. Schools argued that the interests of

the Board in unregulated companies providing key parts of a distributor's business activities closely parallels the interests of the OSFI in the practices of the entities it regulates.

5.10.38 Schools also noted that under clause 44(1)(a) of the Act the Board may make rules governing the conduct of a gas distributor as such conduct relates to its affiliates. Clause 44(1)(g) allows the Board to require an affiliate of a gas distributor to make returns, statements, or reports relating to the sale or distribution of gas by the distributor, in such form, and containing such matters and verified in such manner as the rule may provide. "Sale of gas" in this context means, in Schools' view the entire process by which gas is acquired, transported and sold by the distributor, and entitles the Board to obtain detailed information with respect to the operation of those activities of a distributor's affiliate that pertain to the distribution and sale of gas by the distributor.

5.11 BOARD COMMENTS AND FINDINGS

GENERAL COMMENTS

5.11.1 The Board acknowledges that since the outsourcing fees are a component of ECG's O&M and accordingly included in ECG's TPBR Plan, the outsourcing arrangements have no cost consequences for rates for the 2002 Test Year. The Board notes that it issued the final rate order for 2002 Test Year rates on July 25, 2002.

5.11.2 The Board also notes that this proceeding did not involve a prudence review of ECG's affiliate outsourcing arrangements. Indeed, such a review was not possible, since the outsourcing fees are included in ECG's TPBR Plan and ECG refused to disclose the fees in this proceeding.

5.11.3 In the Decision on the Motion, the Board indicated that ECG was not required to obtain the approval of the Board prior to outsourcing its customer care, information technology and fleet management functions to its affiliate. However, the Decision on the Motion should not be interpreted as encouraging or condoning outsourcing arrangements. Each arrangement must be considered on its own merits and must be considered with respect to the best interests of the utility.

5.11.4 The Board notes that in the past the Board has approved the cost consequences of utility outsourcing arrangements. This is particularly true when the utility is contracting with independent third parties pursuant to a public tender process for routine functions, such as appliance inspection and pipeline construction.

5.11.5 However, the Board agrees with the Intervenors that ECG's affiliate outsourcing arrangements raise a number of serious concerns. The Board's concerns are not limited to the cost consequences of ECG's decision to outsource critical utility functions to its affiliates.

Extent and Nature of Services being Outsourced

5.11.6 The degree to which ECG has outsourced its core utility functions, as complete operations, to its affiliates is of great concern to the Board. The Board is not convinced by ECG's argument that these outsourcing arrangements are no different than continuing the utility's historical practices of contracting for services from unrelated third party providers.

Motives for Outsourcing

5.11.7 The Board shares the Intervenors' skepticism concerning ECG's motives in entering into these affiliate outsourcing arrangements.

5.11.8 While ECG claimed that outsourcing its Operational Services to EOS was driven by concerns regarding system reliability and security of supply, the Board notes that these concerns have not previously been raised before the Board. ECG has an obligation to bring critical operational issues, such as concerns about system reliability and security of supply, to the attention of the Board.

5.11.9 If these were legitimate concerns, ECG did not present evidence in this proceeding that it considered and analyzed other alternatives to resolve these problems. In particular, ECG did not present evidence that it considered and rejected an "in house" solution to these issues.

5.11.10 While ECG alleged that there are "unique staffing requirements associated with gas control operations", the Board does not consider the requirement for supervisory coverage for 24-hours, seven-days a week to be unique. This is, and has always been, a requirement of gas control operations, previously performed by the utility.

5.11.11 With respect to the need to replace the SCADA system the Board notes that the capital requirements of the utility are not covered by its TPBR Plan; and consequently were an issue to be determined in this proceeding. ECG did not present evidence of the cost consequences of replacing the SCADA system. The Board may have determined that the costs of replacing the SCADA system were a legitimate utility expense, and should be included in the capital budget and included in rate base. The analysis of this option was not put before the Board.

5.11.12 The Board is particularly concerned that the evidence indicated that EOS did not in fact have the requisite skill to operate the SCADA system and that ECG personnel were required to provide EOS employees with training.

5.11.13 The fact that EI intended to consolidate its control of its liquids pipelines operations in EOS is not by itself sufficient justification for the Company to outsource its Operational Services to EOS, unless the Company can demonstrate that there were direct benefits to the utility in doing so.

5.11.14 With respect to the Company's decision to outsource Gas Services to EI, while the Company argued that this decision was "driven by the opportunity to achieve benefits in the form of cost efficiencies and improved service quality", ECG did not produce any concrete examples of how these cost efficiencies and improvements in service quality would be achieved. In particular the Board is not convinced by ECG's argument that "specialized expertise" and "market intelligence", available in Calgary, cannot be obtained in Toronto. The Board notes that the Company's witness, Ms Holder, and her group, effectively performed these functions from Toronto for a number of years. The Board also notes ECG's evidence that most employees performing gas supply functions refused to be relocated to Alberta. As a result the utility has lost the benefit of the history, knowledge and expertise of these employees.

5.11.15 The Board notes in ECG's letter to Floyd Laughren dated April 17, 2001 ECG indicated that it was intending to move its employees to Alberta. Not until the evidence in this proceeding did ECG correct this impression and advise the Board that its plans had changed and that it was intending to outsource Gas Services to EI. In addition, the Board agrees with the Intervenors that even if the Company's claims were true, ECG has not presented sufficient evidence that it analyzed the alternative options.

5.11.16 The Board agrees with Intervenors that in a competitive market the economies of scale and scope would not be realized solely by the service provider, but rather would be shared among those procuring the service. ECG's arguments are, to a certain extent, inconsistent. While ECG has argued that ECG ratepayers will benefit from economies of scale and scope, it is also arguing that the cost efficiencies would accrue to EI and EOS and not to ECG.

5.11.17 The Board shares the concerns raised by Intervenors that in long term outsourcing arrangements ECG has an obligation to act in the best interests of the utility, including its ratepayers. While the Board is not inherently opposed to EI or EOS profiting from their relationship with ECG, it is essential that ECG must be able to establish that such arrangements also provide tangible benefits to ECG and its ratepayers. The interests of ECG are in no manner subordinate to the interests of the Enbridge Group as a whole.

5.11.18 ECG's argument that there is "no evidence that outsourcing will harm ratepayers" is not compelling to support these arrangements. ECG must demonstrate not only that the arrangements will not harm ratepayers, but also that there will be a significant and tangible benefit to ratepayers.

5.11.19 ECG has correctly pointed out that in the Decision on the Motion the Board stated that utility customers should be indifferent as to whether customer care, information technology and fleet management are performed by utility employees or a third party affiliate as long as they are being performed to the requisite standard. ECG has claimed that service quality will improve with these outsourcing arrangements.

5.11.20 The Board is not satisfied that merely maintaining the service quality indicators of the TPBR Plan is sufficient evidence to demonstrate improved quality of service sufficient to justify ECG's affiliate outsourcing arrangements.

Potential Consequences of Outsourcing

5.11.21 As the indicated in Chapter 3, dealing with Alliance and Vector, the Board is concerned when a utility engages in transactions where a related entity is a counterparty. Because of the nature of the relationship, there is the possibility of a conflict of interest. The Board is not convinced that the agreements and protocols between ECG and its affiliates are sufficient protection. As a result, the utility has the obligation to establish to the satisfaction of the Board that the transactions are in the best interests of the utility and its ratepayers.

5.11.22 The Board notes the concerns raised by some Intervenors concerning the advantages of separation of utility functions from competitive services and in particular the concern with respect to the potential sharing of confidential information. The Board shares these concerns and notes that the *Gas Distribution Access Code* contains provisions concerning the requirements of a distribution utility with respect to confidential information. It will be incumbent on ECG to establish, to the satisfaction of the Board, that it has maintained the confidentiality of information and has not provided its affiliates with information to the detriment of either ratepayers or the competitive market.

5.11.23 The Board also shares the concerns expressed by many Intervenors concerning the potential for lack of independent action on behalf of ECG. As discussed in greater detail below, the Board reminds the management of ECG that it has an obligation to act independently from its shareholder with a view to acting in the best interests of the utility and its ratepayers.

5.11.24 While the Board is comforted by ECG's assurances that the outsourcing arrangements will not affect the Board's regulatory oversight over the actions of the utility, the Board cautions ECG that the Board is concerned regarding all aspects of utility functions, whether they are provided directly by ECG or by an affiliate under an agency agreement.

5.11.25 In the past, the Board has not generally closely examined ECG's arrangements to enter into discrete contracts with unrelated third parties to provide services such as pipeline construction and appliance inspection. However, as the Board has previously noted, due to the extent and nature of the services being outsourced, the Board has a number of concerns with respect to ECG's outsourcing arrangements. The Board expects ECG and all of its affiliates to co-operate fully with the Board and intervenors in providing all necessary information to enable the Board to continue proper regulatory oversight of the utility.

Specific Concerns of ECG's Outsourcing Arrangements

5.11.26 Even if outsourcing is an appropriate course of action, the Board shares the concerns raised by the Intervenors about some of the contractual provisions and protocols governing these arrangements. The Board specifically notes the concerns raised by Schools about the specific provisions of the agreements. The Board is not convinced by ECG's arguments that the contractual provisions, including the protocols, provide the Board with sufficient comfort that the concerns raised by the Intervenors have been appropriately dealt with.

5.11.27 The Board is aware of the concerns expressed by Intervenors and notes that in consideration of any incentive regulation proposal by ECG, the Board will be mindful of, and take into account, the impact of any outsourcing arrangements.

Transfer Pricing

5.11.28 In any analysis of transfer pricing it is important to start with the basic regulatory principle that all rates charged by a regulated utility must be just and reasonable and, correspondingly, only just and reasonable costs incurred by the utility will be included in a utility's revenue requirement.

5.11.29 When services are being performed for a utility by third parties, and fees for these services have been negotiated at arm's length, in the absence of evidence to the contrary, the Board has confidence that the utility will ensure that the arrangements are prudent and that the costs incurred are just and reasonable.

5.11.30 However, when transactions occur between or among affiliates, the Board will not presume prudence and the onus is on the utility to establish, to the satisfaction of the Board, that the transaction is prudent and that the corresponding costs to the utility associated with the transactions are fair.

5.11.31 Section 2.3.2 of the ARC provides that in purchasing a service, resource or product from an affiliate, the utility "shall pay no more than the fair market value". Therefore the onus is on the utility to establish the "fair market value" for the service, resource or product.

5.11.32 Section 2.3.2 of the ARC continues to state that "a valid tendering process shall be evidence of fair market value". The Board notes that the tendering process must be "valid". The Board agrees with the argument raised by Schools that because of arrangements negotiated between the utility and its affiliate, such as the right of first refusal, that any tendering process may be flawed and may not result in a "fair market value" for the services being tendered. In addition, the Board notes that the ARC states that the valid tendering process is merely "evidence" of a fair market value and is not necessarily determinative of the fair market value.

5.11.33 The Board notes that ECG's evidence was that there are many entities that are capable of providing Gas Services and Operational Services to ECG. Indeed EI's strategy appears to be to develop the capability to provide these services on a competitive basis to a number of parties and thereby benefit from economies of scale.

5.11.34 However, the Board notes that ECG did not conduct a competitive tender for these services. The Company's management has an obligation to ensure that the utility procures services for the most reasonable costs. While the Board is not prepared, at this time, to require the utility to carry out a competitive tender before outsourcing services, the Board notes that the lack of a competitive tender process will make it more difficult for ECG to convince the Board that the fees it is paying for the outsourced services are just and reasonable.

5.11.35 The Board notes that ECG has advised the Board that it "endeavours to establish market prices for all affiliate transactions". The Board expects ECG in its next rates case to provide data and analysis to establish market based prices of all affiliate transactions.

5.11.36 The Board notes that ECG has also advised the Board that "in some cases, due to the nature of the service, it is not possible to establish a comparable market price". If market based data is not available the Board expects ECG to provide evidence that legitimate attempts have been made to establish market-based prices.

5.11.37 Section 2.3.3 of the ARC continues to provide that where a fair market value is not available the utility "shall pay no more than a cost-based price". It is important to note that the cost-based price is the maximum amount to be paid by the utility to its affiliate.

5.11.38 Section 2.3.3 of the ARC provides that "A cost based price shall reflect the costs of producing the service or product, including a return on invested capital. The return component shall be the higher of the utility's approved rate of return or the bank prime rate."

5.11.39 Much of the argument from Union and the other Intervenors centered around the meaning of "cost based price" and whether this provision should be interpreted as being based on the utility's avoided costs or the costs of the affiliate providing the service.

5.11.40 While the Board agrees with Union's argument that in a rates hearing the Board has no jurisdiction over what an affiliate can charge for goods or services, the Board has jurisdiction to determine whether the costs charged by the affiliate for performing these services will be included in rates. Merely because the affiliate is not regulated does not mean that its costs are not relevant.

5.11.41 The Board interprets the meaning of "cost based price" as the affiliate's cost of performing the services and not the avoided costs of the utility, for a number of reasons.

5.11.42 Section 2.2.3 of the ARC provides that the cost based price shall reflect the costs of producing the service or product. The ARC does not refer to the "costs the utility would have incurred in producing the service or product" or the "utility's avoided costs". The cost based price can only refer to the actual costs being incurred in providing the product or services and in an affiliate outsourcing arrangement these costs are in fact being incurred by the affiliate and not by the utility.

5.11.43 The utility must establish not merely that the affiliate outsourcing arrangements are cost neutral to the utility, these arrangements must in fact be of benefit to the utility. In other words it would not make business sense for a utility to enter into outsourcing arrangements with an affiliate, or a third party, unless the costs incurred for the same quality of service, would be less than those incurred directly by the utility performing the service. This is particularly true when, as discussed above, the outsourcing arrangements raise a number concerns that do not directly relate to the costs of the product or service, such as loss of expertise and loss of independence.

5.11.44 The Board agrees with Union' position that reference to the utility's regulated rate of return may not be relevant to the operational parameters, business plans and operations or hurdle rate for investment of the affiliate, and that this would create a mismatch between risk and return to the affiliate. However, as Union has also pointed out, the Board does not regulate the affiliate and consequently the Board is not and should not be concerned with the manner in which the affiliate conducts its business.

5.11.45 Union's argument that a cost based price would mean that the utility would be effectively "expropriating from the affiliate all of the benefits of infrastructure efficiencies and economies of scale" is totally without merit. In fact the Board is concerned that the opposite has occurred; expertise and infrastructure that were previously with the utility have been transferred without appropriate compensation to the affiliate.

5.11.46 The Board notes that the interpretation of the transfer pricing provisions suggested by ECG and Union would mean that the utility and its ratepayers would not benefit from the efficiencies gained as a result of the outsourcing arrangements. The Board questions why a utility would enter into such an arrangement if benefits would not directly accrue to the utility or its ratepayers.

5.11.47 ECG has contended that the utility and its ratepayers would benefit from economies of scale and scope. One of the benefits that the utility brings to an outsourcing relationship is the scale and scope of the services that it requires. This is of benefit to any service provider in that it can leverage the scale and scope provided by the utility and offer similar services to others at a lower average cost than could otherwise be achieved without the utility's business.

5.11.48 If the regulated utility is required to pay its avoided costs, and if these avoided costs are more than the average cost to the affiliate of performing the services, then to the extent that the affiliate provides services to other third parties, the utility would in fact be cross-subsidizing such competitive businesses. In other words, if the affiliate service provider can recover a disproportionate amount of its costs from the regulated utility, it can reduce fees paid by other third parties to attract and retain new business.

While the Board does not directly regulate the competitive market, to the extent that the regulated utility purchases services from an unregulated affiliate, the Board has an interest in ensuring that those services are competitively priced. The Board should not condone actions of the regulated utility which might lead to cross-subsidization and delay the development of a competitive market.

5.11.49 The Board notes that the general role of the regulator is to act as a proxy for competition. In pricing services in a competitive market the relevant costs would be the costs incurred by the service provider in providing the service, plus an appropriate return in order to attract the capital necessary to provide the service. While the utility's avoided costs may be relevant to the utility's decision whether to outsource the procurement of the services or to provide the services directly, they are not relevant in determining the price at which the services should be provided by another party.

5.11.50 Utility ratepayers should not be disadvantaged as a result of the utility's decision to outsource to its affiliate. If the utility performed the services directly, rates payable by ratepayers would take into account not only the utility's costs for performing the services but also the utility's rate of return.

5.11.51 The Board is not convinced of the dire consequences predicted by Union if the Board interprets the ARC as being based on the affiliate's costs.

5.11.52 The matter is quite simple. The provisions in the ARC are to ensure that the ratepayers benefit from the affiliate's lower costs in producing goods or providing services, while an the same time protecting ratepayers from paying rates based on a higher rate of return than would be included if the utility performed the services

directly. If, based on these restrictions, the affiliate decides that it would not be in the affiliate's business interest to provide services to the regulated utility, then so be it.

5.11.53 However, while the prudence of these arrangements is not at issue in this proceeding, the Board notes that in its next rates case, in order for the fees paid by ECG to its affiliates for performing these services to be included in the calculation of the revenue requirement, it will be incumbent on ECG to establish to the satisfaction of the Board that the fees have been prudently and reasonably incurred and that the calculation of the fees is in accordance with the ARC.

5.11.54 The Board notes that in calculating just and reasonable rates, subsection 36(1) of the Act specifically provides that the Board is not "bound by the terms of any contract". While the contractual arrangements between ECG and its affiliates is evidence that may be of assistance to the Board, it is in no manner determinative of the amounts that will be included by the Board in the calculation of rates.

Transfer of Utility Functions

5.11.55 Subsection 18(1) of the Act provides:

> No authority given by the Board under this or any other Act shall be transferred or assigned without leave of the Board.

5.11.56 Subsection 36 (1) of the Act provides:

> No gas transmitter, gas distributor or storage company shall sell gas or charge for the transmission, distribution or storage of gas except in accordance with an order of the Board, which is not bound by the terms of any contract.

5.11.57 In addition, subsection 43(1) of the Act provides:

> No gas transmitter, gas distributor or storage company, without first obtaining from the Board an order granting leave, shall
> (a) sell, lease or otherwise dispose of its gas transmission, gas distribution or gas storage system as an entirety or substantially as an entirety;
> (b) sell, lease or otherwise dispose of that part of a system described in paragraph (a) that is necessary in serving the public...

5.11.58 The Board agrees with ECG that the Board does not directly "authorize" a utility to operate in the Province of Ontario in the same manner that the Director of Licensing licences electricity transmission and distribution utilities.

5.11.59 However, a gas transmitter, gas distributor or storage company can only sell gas or charge for the transmission, distribution or storage of gas in accordance with an order of the Board. While a Board order may not technically be required to operate a gas utility in Ontario, an order of the Board is required in order to charge for selling gas or performing transmission, distribution, or storage of gas.

5.11.60 It is not clear to the Board, based on the evidence in this proceeding, where the central management and control of the utility rests. In other words, it is not clear whether ECG or EI is in fact controlling the operation of the utility.

5.11.61 Even at the oral hearing, ECG witnesses were sometimes confused as to whether a particular action was authorized by the Company or EI's senior management.

5.11.62 The Board notes that directors and officers of a utility have a statutory duty to act in the best interests of the utility, not of its shareholder. Section 134 of the Ontario Business Corporations Act provides that :

> Every director and officer of a corporation in exercising his or her powers and discharging his or her duties shall,
> (a) act honestly and in good faith with a **view to the best interests of the corporation**; and
> (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. (emphasis added)

5.11.63 While the Board has no desire to "micromanage" the operations of the utility nor to take over the "reins of power", to use Union's terminology, the utility has a responsibility to convince the Board that it is being operated in the best interests of the utility.

5.11.64 The Board appreciates that there may be intense personal pressure on individuals within ECG to be "team players" within the "Enbridge Family", and while the maximization of shareholder profits and shareholder value may be the objective of "Enbridge Family" members who are competitive corporations, they are not and should not be the objective of the management staff of ECG, a regulated monopoly utility. The Board is concerned that utility employees are spending time and effort, at the ratepayers expense, trying to leverage the monopoly advantage of the utility for the benefit of its shareholder.

5.11.65 ECG management must be able to establish to the satisfaction of this Board that it has put the interests of the utility first. This is particularly true with a regulated monopoly. Because ratepayers are captive customers of the utility, its management has a high standard to act in the best interests of the utility, including its ratepayers.

5.11.66 The Board also has an overriding obligation to ensure that the utility acts in the public interest. The Board has always recognized that part of the public interest is to ensure that the utility shareholder has the opportunity to earn a fair, but only fair, rate of return on its investment. Unlike other competitive businesses, the obligation of ECG's officers and directors is not to maximize the return to the shareholder by complex schemes including outsourcing to affiliates. EI appears to have treated utility assets as exclusively its own for the purpose of maximizing its own profits.

5.11.67 The Board shares the concerns raised by Intervenors that ECG , as on Ontario-based regulated utility cannot, through the use of agency arrangements with an unregulated entity outside the province, eliminate or avoid the Board's regulatory oversight. The Board's regulatory oversight is not limited to either approving or disapproving the rate consequences of these arrangements.

5.11.68 ECG and the Intervenors have agreed that Gas Services and Operational Services are integral and critical to the physical transmission, distribution and storage functions. The collective impact of the outsourcing arrangements are that ECG may no longer control critical elements of the gas transmission and distribution system that are necessary in serving the public.

5.11.69 The Board is concerned that ECG may have breached paragraph 43 (1)(b) of the Act. The purpose of paragraph 43(1)(b) of the Act is to ensure that a gas transmitter, gas distributor or storage company cannot "sell, lease or otherwise dispose of" any part of the gas transmission, distribution or storage system that is "necessary in serving the public". The Board notes that the wording of this provision is very broad and prohibits the utility from not only selling or leasing but "otherwise disposing" of any part of the system necessary in serving the public.

5.11.70 The Act does not define a "gas transmission system", or a " gas distribution system"; however, the Act defines a gas distributor as "person who delivers gas to a consumer" and a gas transmitter means " as a "person who carries gas by hydrocarbon transmission line".

5.11.71 A gas transmission system and gas distribution system clearly means more than the physical transmission and distribution system assets, such as pipelines, compressors and related facilities. It includes all aspects that are necessary in serving the public. This would include the SCADA system necessary for Gas Operations as well as the experience and expertise of personnel to conduct Gas Operations and Gas Supply.

5.11.72 It is clear that prior to entering into the outsourcing arrangements with its affiliates, ECG itself had all of the assets, including expertise, to operate a gas transmission and gas distribution system. It is unclear to the Board whether this is still the case. It is the Board's view that if ECG does not in fact have the ability to operate the gas transmission and gas distribution system on a stand alone basis, then it has "otherwise disposed" of part of its system, necessary in serving the public, contrary to the provisions of paragraph 43(1)(b) of the Act.

5.11.73 The Board is extremely concerned with maintaining the safety, security and reliability of the delivery of gas in Ontario. Based on the evidence in this proceeding the Board is not convinced that ECG, as a separate regulated utility, has retained the necessary control and management to operate the utility.

Remedies and Jurisdiction

5.11.74 The Board is not convinced by ECG's argument that the Board has limited jurisdiction over competition. Subsection 36(1) of the Act provides that "No gas transmitter, gas distributor or storage company shall sell gas ... except in accordance with an order of the Board". One of the objectives set out in Section 2 of the Act is to facilitate "competition in the sale of gas to users". While sections 46-55 of the Act deal with the sale of gas to low volume consumers, in the Board's view there is nothing in section 36(1) to limit the objectives set out in section 2 to merely refer to low volume consumers.

5.11.75 In the Board's view, in order to fulfil the statutory objective of facilitating competition in the sale of gas to users, the Board must take into account all stages in the distribution chain. Merely because neither section 2 nor subsection 36(1) specifically refer to "energy services", "competitive services", "competitive businesses", "competitive markets", "competitive energy activities" or "competitive wholesale services", does not mean that the Board should not be aware of these activities and take them into account when overseeing the regulated utility activities of ECG.

5.11.76 The Board is also not persuaded by ECG's argument concerning the application of the principle of territorial incompetence. While the Board may not have the power to regulate the decisions of persons, activities or things wholly outside the province, the Board does have the power to take into account activities outside the province that may have an impact on competition inside the province. While the Board does not have regulatory oversight over the wholesale markets and other energy services outside the province, the Board clearly has jurisdiction over the activities of ECG, a regulated utility, which may have an effect on competition in the sale of gas to users in Ontario.

5.11.77 The Board's authority relating to the sale of gas by a utility, by necessary implication, includes its procurement. For example, the Board is concerned with ECG's risk management policies and procedures relating to the procurement of gas. The fact that these policies are currently being reviewed is indicative of the Board's concern.

5.11.78 In reviewing the Board's jurisdiction under section 36 it is important to look at the framework of this provision as a whole.

5.11.79 Subsection 36(1) of the Act provides that :

> No gas transmitter, gas distributor or storage company shall sell gas or charge for the transmission, distribution or storage of gas, except in accordance with an order of the Board, which is not bound by the terms of any contract.

5.11.80 Subsection 36(2) of the Act provides that:

> The Board may make orders approving or fixing just and reasonable rates for the sale of gas by gas transmitters, gas distributors and storage companies and for the transmission, distribution and storage of gas.

5.11.81 Subsection 36(4) of the Act provides that an order under section 36 may "include conditions, classifications or practices applicable to the sale, transmission, distribution or storage of gas, including rules respecting the calculation of rates".

5.11.82 While historically the Board has referred to an order granted under section 36 as a "rate order", there is nothing in this provision that limits the Board's jurisdiction to only setting rates. Subsections (1) and (2) of section 36 are separate and distinct provisions, requiring separate and distinct orders from the Board: subsection 36(1) provides in effect that if a gas transmitter, gas distributor or storage company sells gas or charges for the transmission, distribution or storage or gas, it requires an order of the Board; and subsection 36(2) provides that the Board may make an order approving or fixing just and reasonable rates for the transmission, distribution or storage of gas.

5.11.83 The Board notes that while the requirements of subsection 36(1) are mandatory, the provisions of subsection 36(2) are permissive. In other words, a gas transmitter, gas distributor or storage company is prohibited from selling gas or charging of the transmission, distribution or storage of gas without an order of the Board authorizing these activities. However, subsection 36(1) is silent on the rate that the utility may charge for selling gas or performing these transmission, distribution or gas storage services. Subsection 36(2) is permissive and provides that the Board may make orders approving or fixing just and reasonable rates. Ironically what is the point? the legislation does not mandate the Board to approve or fix rates that the utility may charge for selling gas or performing transmission, distribution or storage services; however, if the Board does exercise its discretion and make an order under subsection 36(2), the rates it approves or fixes must be "just and reasonable".

5.11.84 ECG's argument would lead to the interpretation of subsection 36(1) as meaning that a gas distributor, transmitter or storage company shall only charge rates approved by the Board for the sale, distribution, transmission or storage of gas.

5.11.85 The Board's interpretation of subsection 36(1) of the Act is that an order of the Board is required for a gas transmitter, gas distributor, or storage company to sell gas or charge for the transmission, distribution or storage of gas. The Board has authority to regulate the activity of selling gas, transmitting, distributing or storing gas, not merely to regulate the fees charged for performing these activities.

5.11.86 The Board's authority for approving or fixing just and reasonable rates for the sale of gas by a gas transmitter, gas distributor or gas storage company and for the transmission, distribution and storage of gas, is found in subsection 36(2) of the Act. ECG's interpretation of section 36 would render the authority of the Board to grant an order under subsection 36(1) as meaningless, since the Board would in fact be limited only to granting rate orders under subsection 36(2).

5.11.87 The Board agrees with Intervenors that to interpret this provision otherwise would lead to the absurd conclusion the utility would be able to sell gas or transmit, distribute or store gas in any manner that it chose and the Board's only recourse would be to limit the cost recovery in rates.

5.11.88 If the Board were to find that EI, EOS or any combination of affiliates of ECG, are in fact acting as a gas transmitter, gas distributor or storage company and charging for the transmission, distribution or storage of gas without an order of the Board, contrary to subsection 36(1) of the Act, and without the leave of the Board, pursuant

to subsection 18(1) of the Act transferring the authority to charge for such services from ECG, then the Board will take appropriate action.

5.11.89 The Board notes that the conditions, classifications or practices that may be included in the order apply to the activities of the sale, transmission, distribution or storage of gas and are not limited to the rates charged with respect to the carrying out those activities. Indeed, the phrase "including rules respecting the calculation of rates" indicates that the specific authority to include conditions, classifications and practices is broader than merely setting rules respecting the calculation of rates. ECG's interpretation of the section would limit the Board's authority to setting rules respecting the calculation of rates and would ignore the broader statutory mandate that precedes it.

5.11.90 The authority of the Board under subsection 36(4) to include conditions, classifications or practices applicable to the sale, transmission, distribution or storage of gas deals with an order under section 36, which would include an order under subsection 36(1) and is not limited to a rate order under subsection 36(2).

5.11.91 Section 23 of the Act provides that "The Board in making an order may impose such conditions as it considers proper, and an order may be general or particular in its application." First, there is nothing in section 23 to indicate that the general power to impose conditions is in any way limited or circumscribed by the Board's power under subsection 36(4) of the Act. Secondly, subsection 36(4) is in fact broader than section 23 and provides that an order of the Board under section 36 may include not only conditions but also "classifications or practices" applicable to the sale, transmission, distribution or storage of gas, including "rules" respecting the calculation of rates.

5.11.92 The Board agrees with ECG that there must be a reasonable "nexus" between the order granted and the conditions imposed. The Board notes that while the conditions requested by the Intervenors do not necessarily deal with the rates imposed by the Board under subsection 36(2) of the Act, they do deal with the activities of the utility, selling gas or transmitting, distributing or storing gas that are authorized under subsection 36(1) of the Act.

5.11.93 The Board is not sympathetic to ECG's argument concerning the "practical difficulty or requiring ECG to compel or direct affiliates in circumstances where ECG has no power to do so". The Board did not require ECG to enter into these outsourcing arrangements with its affiliates: it did so voluntarily. ECG was or should have been aware at the time of entering into these arrangements that the Board was concerned in general about the relationship between a regulated utility and its affiliates.

5.11.94 The Board finds that it has the jurisdiction to impose conditions, such as those requested by the Intervenors.

5.11.95 However, the Board is not convinced that it is necessary in this proceeding to grant Schools' request that the Board order that the business activities transferred to EI and EOS be repatriated to ECG. First, it is unclear whether ECG has in fact transferred the control and management of these activities to EI and EOS. Secondly, if the benefits of improved efficiencies and quality of service are realized, as claimed by ECG, utility ratepayers may indeed benefit from these affiliate outsourcing arrangements.

5.11.96 The Board notes with interest the OSFI Guidelines filed by Schools in this proceeding. Consideration should be given to including similar guidelines in the ARC.

Conclusion

5.11.97 ECG has not convinced the Board that these outsourcing arrangements are beneficial to the utility. The Board notes that Intervenors have raised a number of legitimate concerns regarding the potential negative impact on the utility and its ratepayers.

5.11.98 The Board expects ECG in the next rates case to provide clear and quantifiable evidence demonstrating that its outsourcing arrangements have in fact resulted in benefits to the utility in terms of economies of scale and scope and improvements in system reliability, security of supply, cost efficiencies and service quality.

5.11.99 It will also be incumbent on ECG in the next rates case to adduce sufficient evidence to satisfy the Board that:

- ECG management retains and exercises independent decision-making authority to ensure that ECG is being operated in the best interests of the utility; and
- the outsourcing arrangements have not in any manner threatened the ability of ECG to perform its business objective, which is to ensure the safe, secure and reliable delivery of gas in the Province of Ontario.

6. ADDITIONAL MATTERS

6.1 DISCLOSURE

6.1.1 A number of intervenors expressed concern that in this proceeding ECG had repeatedly breached its disclosure obligations, as articulated by the Board in the Decision on the Motion.

6.1.2 Intervenors noted generally the following areas of concern:

- the quality of the pre-filed evidence;
- the quality of responses to written interrogatories;
- the quality of responses to questions posed in cross-examination; and
- post-hearing disclosure.

Alliance Vector

6.1.3 With respect to disclosure on the issue of the prudence of ECG's decisions to contract for capacity of the Alliance Vector pipelines intervenors noted that ECG did not initially disclose the business case for the prudence of its decisions during the discovery phase of Alliance Vector issue. In the second tranche of interrogatories, ECG played what CAC described as a "cat and mouse game" in its responses, giving

the intervenors, in a number of instances, answers that were incomplete, and therefore misleading. Throughout the process, the intervenors not able to elicit all of the relevant supporting information which "hampered" the ability of intervenors to examine the issue and to be able to cross-examine on the basis of it.

6.1.4 CAC believed that without the intervention of the Board in asking for the production of further and better information during the oral hearing, ECG would not have disclosed to the intervenors the full story of the Alliance and Vector contracts.

6.1.5 Intervenors expressed concern that ECG used the presumption of prudence as a excuse for not providing information and relying solely on the criticism of the evidence of others. Intervenors indicated that it was apparent that ECG did not believe that it had an obligation to provide all relevant information in support of its application and that the Company would supply only that information which it regarded as helpful to its own case.

6.1.6 Intervenors noted that while greater reliance is being placed on the adversarial model with intervenors raising issues and eliciting information that will allow the Board to make its decision, there is a significant imbalance between the resources available to ECG and to the intervenors in the presentation of their respective cases and intervenors must rely almost entirely on ECG's willingness to provide information. In particular, CAC submitted that it is apparent that ECG believes that its objective is not to meet its statutory obligations but rather to "defeat" the intervenors by using tactics that would be unacceptable under the rules of conventional civil litigation.

6.1.7 Intervenors also expressed concern with respect to ECG's record keeping practices with respect to the Alliance Vector contracts. Intervenors noted that documentation created contemporaneously with the decision-making process is necessary in order to assist the Board in ensuring that ECG is held accountable for its decisions. Inadequate record-making practices on the part of ECG had an impact on the ability of intervenors and the Board to assess the prudence of entering into the Alliance Vector contracts. Although ECG witnesses admitted that they "clearly knew" that they would be in front of the Board one day explaining what they did; nonetheless, ECG did not create a proper "paper trail" or evidentiary record so that it could provide objective evidence to intervenors and the Board. Intervenor's noted that since staff inevitably leave the utility and knowing that memories fade with time, ECG should have been documenting its decision-making process.

Affiliate Outsourcing

6.1.8 Intervenors reminded the Board that even though the had been considering outsourcing operations to its affiliates since 1998, it did not initially disclose its outsourcing plans to the Board in brief letters to the Board Chair until August 2000 for Operational Service and April 2001 for Gas Services. Nothing further was disclosed to the Board or intervenors until the prefiling of evidence in these proceedings on September 25, 2001.

6.1.9 On the issue of the disclosure of the CustomerWorks/ Accenture transaction after the close of the oral hearing, intervenors noted that as part of its pre-filed evidence, ECG referred to the agreement with CustomerWorks; however, at no time prior to the press release on July 19, 2002 , did ECG advise the Board or the intervenors that the

pre-filed evidence should be amended, or read in light of the proposed agreement with Accenture.

6.1.10 Intervenors noted that in the Decision on the Motion the Board made it clear that the provision of customer care services to ratepayers is an important aspect of utility services and plans to materially change the manner in which customer care services are to be provided to ratepayers must be disclosed by ECG in a timely manner, even though prior Board approval for the arrangements may nor be required. At the most basic level, ECG was under an obligation to advise the Board and the parties of material changes in its pre-filed evidence. It did not do so.

6.1.11 Intervenors argued that since the arrangements between CustomerWorks and Accenture may have an impact on the provision of services by ECG to its ratepayers and on the rates which those ratepayers pay, ECG was under an obligation to disclose the agreement, particularly in the course of a hearing in which outsourcing arrangements are an issue being considered by the Board.

6.1.12 With respect to the testimony of Mr. McGill and his subsequently filed affidavit sworn July 26, 2002, (the "McGill Affidavit") , intervenors expressed concern that Mr. McGill, testified at the oral hearing about the benefits to ECG of acquiring services from CustomerWorks, while at the same time he was aware of the negotiations with Accenture and that ECG's consent was required to the assignment of the agreement. Consequently Mr. McGill's testimony created the misleading impression that the agreement with CustomerWorks would continue. Neither Mr. McGill nor ECG asserted that the failure to disclose the fact that a new arrangement to provide customer care services to ratepayers was under consideration was an

oversight. Intervenors's therefore claimed that there had been a deliberate withholding of information without justification.

6.1.13 Mr. McGill should either not have testified or he should have disclosed to the Board, in advance, the constraint he felt he was under and obtained direction from the Board on whether he could testify and, if so, on what terms.

6.1.14 Intervenors claimed that the confidentiality acknowledgement signed by Mr. McGill in favour if EI is not a defence to Mr. McGill's actions, for several reasons since:

- a commercial arrangement does not override the legal obligations created when a witness swears an oath;
- ECG and its witnesses have an obligation to disclose to the Board information that affects their pre-filed evidence and which is relevant to an issue before the Board;
- Mr. McGill could have, but apparently did not, sought permission from EI to waive the constraints ostensibly placed on him by the confidentiality acknowledgement;
- the confidentiality acknowledgement, by its terms, did not preclude disclosure to ECG's regulator of information which ECG's regulator has ruled ECG has an obligation to disclose;
- EI cannot "muzzle" ECG employees and preclude them from fulfilling their disclosure obligations by publishing a generic brochure governing business conduct.

6.1.15 Intervenors noted that neither Mr. McGill nor the Company sought to disclose any information to the Board in confidence pursuant to the Board's *Rules of Practice and Procedure*, rather, they took it upon themselves to remain silent throughout the evidentiary phase in these proceedings and in the submission of the Argument-in-Chief.

6.1.16 IGUA submitted that ECG has an obligation to make detailed and timely disclosure of it plans, prior to their implementation, regardless of whether prior Board approval is required if the plans:

- will materially change the way the Company performs utility functions, whether or not there is any immediate impact on rates;
- will have a long-term effect on rates; or
- if they raise issues with respect to the policy framework that the Board has established.

6.1.17 IGUA urged the Board to find that ECG's disclosure of its plans to outsource the performance of utility functions, being after the fact, piecemeal, and incomplete was both untimely and inadequate. The quality of disclosure provided by ECG constituted a breach of its obligation to keep the Board and intervenors informed in a timely manner of changes in the Company's business plans which, if implemented, would materially alter the way the utility performs its utility obligations.

The Company's Position

6.1.18 ECG summarized the issues with respect to disclosure as follows:

- Does a regulated utility have a duty to disclose management decisions that do not require regulatory approval?
- If there is a duty to disclose such decisions, when does it arise?
- If there is a duty to disclose, what exactly needs to be disclosed?
- Did ECG breach its obligation in respect of the disclosure of decisions to outsource utility functions?

6.1.19 ECG's position on these issues was as follows:

- as a matter of courtesy and having regard to the Board's rate-making responsibilities it "behooves" a utility to inform the Board of material and significant management decisions that affect the business of the utility, even if such decisions do not require prior Board approval and have no current rate-making implications;
- if no regulatory approval is required, ECG's responsibility to inform the Board does not require it to do so in advance of decisions becoming final; and.
- if no prior regulatory approval is required, the information to be provided to the Board is within the sole discretion of ECG. ECG claimed that it should, and that it will, endeavour to provide the Board with sufficient detail to enable the Board to respond to general inquiries about the utility's actions, from the government, from the public, and from ratepayers.

6.1.20 It was ECG's position that it did not breach its responsibility to disclose management decisions to outsource utility functions. ECG argued that the management of ECG is required to ensure the provision of safe and reliable service in a cost effective manner. In this regard, it is accountable to the Board and to ratepayers. Accountability, however, requires responsibility. ECG argued that it cannot be held to account if the Board and ratepayers "micromanage" ECG's business.

6.1.21 ECG argued that intervenors appear to suggest three possible sources of such a duty:

- the Board's "right to know";
- an intervenors's right to know and be "consulted"; and
- the Decision on the Motion wherein the Board referred to ECG's duty of "full, true and plain disclosure".

6.1.22 ECG argued that suggestions that the Board has an inherent right to know about significant ECG plans and decisions appear to stem from the idea that the Board's regulatory oversight is plenary and that "without perfect and complete information about every aspect of ECG's business", this oversight responsibility will be compromised.

6.1.23 The Board does not have "perfect and complete information" about rate-making which is clearly within the Board's mandate. ECG argued that this aspect of the disclosure issue is directly linked to the issue of the Board's jurisdiction. ECG reiterated its argument that the Board's jurisdiction is not plenary and it has no statutory mandate to oversee or supervise the business of the utility.

6.1.24 ECG argued that if the Board does not require particular information to carry out the its mandate (which ECG limited to leave to construct, approving rates, and ensuring compliance with rules made under section 44 of the Act) it is difficult to understand how ECG could have a duty to disclose such information.

6.1.25 ECG acknowledged that courtesy would have it inform the Board of material and significant management decisions that affect the business of the utility, even if such decisions do not require Board approval and have no current rate-making implications. In this regard, ECG pointed out that it did inform the Board, through letters to its chairman, of decision to outsource Operational Services, and subsequently, Gas Services.

6.1.26 ECG accepted that intervenors are entitled to the information that is relevant in a particular application or proceeding, and ECG also recognized the value in consulting with the intervenors in order to resolve issues outside the hearing room. ECG did not accept, however, that "intervenors have any rights to, in effect, micromanage the utility".

6.1.27 ECG argued that the Decision on the Motion must be read in its proper context and that it is not precedent for an open-ended obligation to disclose decisions or plans, when there are no rate-making implications, let alone no need for Board approval.

6.1.28 ECG submitted that the obligation to disclose a"material change", as requested by some intervenors, usually means the obligation to disclose something significant that has occurred. In support of this interpretation, the Company sited the Ontario securities laws as they pertain to "continuous disclosure".

6.1.29 ECG argued if ECG were required to disclose plans which the utility is contemplating it would prejudice ECG's ability to carry out its intentions whether acting alone or with a third party. ECG suggested that premature disclosure ECG, could require premature disclosure of a third party, including EI under Ontario and other securities laws. "Securities regulators typically frown on premature disclosure".

6.1.30 ECG noted that the Company and EI, as reporting issuers, are subject to Ontario securities laws. ECG expressed concerns about intervenors' suggestions that ECG disclose intentions or plans to intervenors since, at that time, under Ontario securities laws, ECG would be guilty of premature disclosure

Remedies

6.1.31 Intervenors suggested the following remedies:

- the Board should impress on ECG its obligation to be forthcoming in response to the written interrogatories that are delivered to it;
- the Board should remind ECG of its obligation is to meet certain statutory tests and not "win" some imagined contest with intervenors;
- ECG should be told with respect to questions asked in cross-examination and with respect to the written interrogatories it is inappropriate to "parse" the interrogatories in order to determine the minimum level of information necessary to provide in response. Where ECG is uncertain about the nature and extent of the information that is being sought, it should be instructed to contact the person who has delivered the written interrogatory to ask for clarification;

- the Board should order that ECG is not entitled to recover in rates its costs, both external and internal, in the presentation of the Alliance/Vector portion of the application;
- the Board should find and state in its Decision With Reasons that by failing to disclose during the evidentiary phase of these proceedings and in its written Argument-in-Chief any information pertaining to ECG's role in the CWLP/Accenture arrangements, Mr. McGill and ECG breached the disclosure obligations which the Board articulated in its Decision on the Motion;
- the Board's order should contain provisions which will limit the amounts being paid by ECG to CWLP on and after August 1, 2002 to the amounts being paid by CWLP to Accenture's subsidiary;
- the Board's order concluding these proceedings ought to require ECG to file evidence in its fiscal 2003 rates application to demonstrate that its arrangements with CWLP have been adjusted to comply with the "service provider cost" approach specified in the provisions of paragraph 2.3.3 of the ARC;
- the Board should impose a sanction on ECG, in the form of disallowing some or all of ECG's costs for this proceeding, since without a sanction, ECG will continue to ignore its obligation to disclose; and
- the Board should set out rules governing the production of evidence.

6.2 BOARD COMMENTS

6.2.1 ECG's obligation to disclose was discussed in the Decision on the Motion, where the Board stated:

> The Company has an affirmative obligation to provide the Board with the best possible evidence and it is not incumbent on the intervenors to ensure, through cross examination of the Company's witnesses, that the record is adequate and complete. The Company cannot shirk its responsibilities as a regulated entity by submitting evidence that is vague and incomplete.

6.2.2 In the Decision on the Motion, the Board also quoted its previous decision in E.B.R.O. 452, when it stated:

> The system required the regulator to act on faith with the utility, bearing in mind the prospective nature of the evidence. The regulator expects the utility, in return, to provide the best possible forecast data that can be made available, on a timely basis.

6.2.3 ECG's obligation to disclose starts with the filing of its application. It is important that the application be filed on a timely basis. The Board notes that over the past few years ECG has been increasingly late in filing its application. For example, in this proceeding the application was not filed until September 25, 2001, less than one week prior to the beginning of the 2002 Test Year. It is difficult, if not impossible, for the Board to issue a decision and ultimately a rate order in a timely fashion, and avoid the possibility of retroactivity, if the original application is not filed well in advance of the beginning of the test year.

6.2.4 It is also important that the application be complete and include all of the supporting evidence and documentation, including statements of underlying assumptions and analysis. The Board notes that in this proceeding, ECG's original application was "vague and incomplete" and that the Company continued to supplement and update evidence and file new evidence well into the oral phase of the proceeding, almost nine months after the original application was filed.

6.2.5 ECG controls not only the relevant information but also the timing and manner of its disclosure. As the Board has previously stated, as a regulated utility, ECG has an affirmative obligation to disclose all information relevant and necessary for the evidence to be tested and for the Board to make the necessary determinations and findings.

6.2.6 The information must also be presented in a manner that is clear, concise and easily understandable to those experienced and knowledgeable in the field. It is not of assistance to the Board to present the information in a manner that tends to obfuscate its relevance to the proceeding.

6.2.7 It appears that ECG is not providing the "best possible evidence" in its original application but has a strategy of waiting for Board staff and intervenors to elicit additional evidence through interrogatories and cross examination before providing it to the Board. This approach is not acceptable.

6.2.8 It would be helpful if ECG were to review standard interrogatories that have been filed in previous rates hearings and to include this information in its pre-filed evidence. This approach might reduce the time and resources devoted to the interrogatory process by all parties.

6.2.9 If ECG files its evidence in a timely fashion the Board expects intervenors to do likewise.

6.2.10 While the Board appreciates that, to a certain extent, a rates hearing is an iterative process, it is critical that all relevant material should be filed as soon as possible, to give the Board and the parties the opportunity to properly review and analyze it in a timely manner during the course of the proceeding.

6.2.11 For example, critical information, such as the Otsason Memo concerning the Alliance and Vector pipelines, was not included in ECG's pre-filed evidence and was not disclosed until May 27, 2002, just before the oral phase of the hearing. This approach did not give the Board and intervenors the opportunity to review and analyze the information in order to properly prepare for the oral phase of the proceeding.

6.2.12 As well, information such as the business case for DPWAMS, even though requested in the intervenors interrogatories, was not filed until just prior to the Settlement Conference. Again, this approach made it difficult for the Board to properly analyze and review the information in order to make an informed decision on the issue.

6.2.13 The lack of timely and complete disclosure is evidenced by the large number of exhibits filed and undertakings given during the course of the oral proceeding. While the Board appreciates the efforts by ECG's witnesses to attempt to respond to undertakings given during the oral hearing in a timely manner, the Board notes that many undertaking responses were not given until near the end of the oral hearing. This afforded the Intervenors and the Board no time to review and analyze the

material, ask for clarification and, if necessary, further information prior to completion of the evidentiary phase of the proceeding.

6.2.14 ECG's general approach to disclosure in this proceeding has not been helpful. In order for the Board to fulfill its mandate, it must first understand the operations of the utility and the business model it is operating within. This can only be accomplished by the utility providing the Board with clear and concise explanations of its operations and business processes. Without full and complete disclosure it is difficult for the Board to understand the business of the utility and to be "lighthanded" in the Board's regulatory approach.

6.2.15 Likewise the Board reminds intervenors that all intervenors evidence, including discussion papers, should be properly introduced by appropriate witnesses and should not be provided to the Board for the first time in argument.

6.2.16 The Board is also concerned that ECG failed to disclose that it was considering consenting to the assignment of the contract to provide customer care services from CWLP to Accenture. In this case, the Board and the Intervenors were left with the distinct impression that it was the intention of ECG that customer care services would be performed for the utility during the 2002 Test Year by CWLP. At no time did ECG's witness indicate that its intention might be otherwise, even though it is clear, with information disclosed after the completion of the oral phase of the hearing, that ECG witnesses were involved in the proposal to assign the CWLP agreement to Accenture. Indeed this information was not disclosed to the Board until the same time as a press release was issued.

6.2.17 The Board is not convinced by ECG's arguments that its employee, Mr. McGill, was unable to disclose this information because he had signed a confidentiality agreement with EI. The Board stresses that a regulated utility and its affiliates cannot circumvent the utility's obligation to provide full disclosure to the Board by signing self-serving documents. The obligation to disclose to the regulator overrides any contractual obligation that an employee might have not only to the utility, but also to any third party, including its ultimate parent. ECG could, and should, have availed itself of using the Board's *Rules of Practice and Procedure* to disclose the material in confidence to the Board.

6.2.18 Likewise a utility's obligation to disclose its plans for the test year to the Board is not subordinate to the requirement of timely disclosure to securities regulators. Parties dealing with regulated utilities, such as ECG, should be aware that regulated utilities may have an obligation to disclose information to its regulator that an unregulated business could retain in confidence.

6.2.19 While ECG has argued that the entity who performs customer care services is not relevant for rate-making purposes for the 2002 Test Year, once affiliate outsourcing arrangements became an issue in this proceeding, ECG had an affirmative obligation not to mislead the Board. It has failed in fulfilling that obligation.

6.2.20 It is crucial for the integrity of the regulatory process that the Board is able to rely on the utility to be honest, forthcoming and complete in its evidence before the Board. The utility has an affirmative obligation not to make a false or misleading representation to the Board. The Board notes that, in determining whether the impression is false or misleading, the Board must take into account the general impression conveyed by the representation, as well as its literal meaning. In other

words, the evidence of a utility may be literally accurate, yet leave the Board with a general impression that is false.

6.2.21 The Board has always relied on the good faith of the utilities in making timely, complete and accurate disclosure of all information relevant to the operations of the utility, whether of not the specific information has a direct impact on the Board's rate-making function. If this is no longer the case, the Board will have no alternative but to consider other regulatory tools available to it, such as: including conditions regarding disclosure in orders, requiring the preparation of evidence pursuant to subsection 21(1) of the Act, and making rules pursuant to paragraphs 44(1)(f)or(g) of the Act.

6.2.22 Finally, the Board notes that additional evidence and supplemental arguments were sent to the Board well after the applicable filing deadlines had expired. At some point the filing of information and arguments must stop. Constant bickering about who gets the last word only lengthens the regulatory process. The parties must rely on the Board to determine the weight and relevance of the material submitted.

6.2.23 The Board is aware that timeliness of decisions is an issue for not only ECG and the Intervenors but also for the Board. The Board would be greatly assisted in its obligation to issue decisions in a timely fashion, if all parties acted on these comments.

6.3 OTHER COMMENTS

6.3.1 In the past the Board has been impressed with and greatly assisted by the quality of the arguments and the professional approach of the parties. However, the Board is deeply concerned about the general deterioration of tone in this proceeding.

6.3.2 The Board reminds the parties that it is essential for all parties to show respect and professional courtesy throughout the course of the proceeding, including the argument phase. Inflammatory rhetoric and gratuitous remarks may impress clients; however, they hinder the regulatory process and detract the Board from its ability to carefully review and analyze the merits of the case in coming to its decision.

6.3.3 The Board is confident that the parties will heed these remarks and will return to their usual respectful demeanour in future proceedings.

7. COSTS AWARDS

7.1 SUBMISSIONS

7.1.1 The Board received submissions and claims for costs from the following parties:

- CME
- HVAC Coalition
- IGUA
- VECC
- Schools
- CEED
- CAC
- Pollution Probe
- GEC

7.1.2 In a letter to the Board, dated November 4, 2002, ECG stated that it had no objection to the cost claims requested.

7.1.3 The Board notes that some of CEED's cost claims relate to its participation in the RP-1999-0001 proceeding. At that time, the Board anticipated that there would be a second phase of the proceeding, dealing with issues of particular interest to CEED. Accordingly CEED did not make any cost claims for its participation in the first phase of the RP-1999-0001 proceeding. Since the second phase of the RP-1999-0001 proceeding did not take place, the Board has agreed that CEED may include its

cost claims for the RP-1999-0001 proceeding along with its cost claims in this proceeding.

7.2 COST AWARDS

7.2.1 The Board awards the following parties 100% of the reasonably incurred costs in connection with their participation in this proceeding, subject to assessment by the Board's Cost Assessment Officer.

- CME
- HVAC Coalition
- IGUA
- VECC
- Schools
- CEED
- CAC
- Pollution Probe
- GEC

7.2.2 The Board directs the Cost Assessment Officer to review the costs claimed and to make adjustments as necessary to ensure that they are consistent with the Board's Cost Assessment Guidelines.

7.2.3 The Board orders that the eligible costs of the intervenors, as assessed by the Board's Cost Assessment Officer, shall be paid by Enbridge Gas Distribution Inc.

7.2.4 The Board's costs of and incidental to the proceeding shall be paid by Enbridge Gas Distribution Inc. upon receipt of the Board's invoice.

DATED December 13, 2002

Sheila K. Halladay
Presiding Member

A. Catherina Spoel
Member

Bob Betts
Member