E.B.O. 195

IN THE MATTER OF the Ontario Energy Board Act, R.S.O. 1990, c. O.13;

AND IN THE MATTER OF an Application by Westcoast Energy Inc. and its subsidiaries Centra Gas Ontario Inc. and Union Gas Limited for leave of the Lieutenant Governor in Council to amalgamate Centra Gas Ontario Inc. and Union Gas Limited;

AND IN THE MATTER OF Undertakings given by Westcoast Energy Inc. and its subsidiaries Centra Gas Ontario Inc., and Union Gas Limited, dated July 22, and November 27, 1992 respectively.

BEFORE: M. C. Rounding
Chair and Presiding Member

P. Vlahos
Member

H. G. Morrison
Member

REPORT OF THE BOARD

March 7, 1997

TABLE OF CONTENTS

LIST OF FINDINGS

1. INTRODUCTION

1.1 THE PROCEEDING

1.1.1 Westcoast Energy Inc. (“Westcoast"), Centra Gas Ontario Inc. (“Centra”) and Union Gas Limited (“Union”) (collectively “the Companies" or "the utilities”) applied to the Ontario Energy Board (“the Board”) on September 25, 1996 (“the Application”) under section 26 of the Ontario Energy Board Act, R.S.O. 1990, c. O.13 (“the OEB Act" or "the Act”) for leave of the Lieutenant Governor in Council ("the LGIC") to amalgamate Centra and Union. The Companies have also proposed to make certain amendments to the undertakings given by the Companies to the LGIC, dated July 22, 1992 and December 16, 1992 respectively (“the Undertakings”) as a result of the proposed amalgamation. The Application was assigned Board File No. E.B.O. 195.

1.1.2 On October 11, 1996 the Board issued a Letter of Direction requiring the Companies to publish a Notice of Application.

1.1.3 On November 21, 1996, the Board issued Procedural Order No. 1 setting out certain dates relating to the hearing of the Application.

1.1.4 On December 6, 1996 a Technical Conference was held for the purpose of reviewing the Companies’ prefiled evidence and defining the issues related to the hearing of the Application. At the Technical Conference it was noted that the Companies had completed a review of the alternatives for naming the merged company and that it is to be named Union Gas. The chosen name for the merged company will not be used

in this Report to avoid any confusion with the existing Union company. In the prefiled material, the name Mergeco was used to refer to the merged company.

1.1.5 On December 10, 1996 the Companies filed an amended Application to correct the effective date of proposed amalgamation from December 31, 1997 to "no later than January 1, 1998".

1.1.6 An Issues Day was held on December 10, 1996. On December 11, 1996, the Board issued Procedural Order No. 2 defining the issues to be addressed in the hearing.

1.1.7 The Board issued a Notice of Hearing on January 3, 1997.

1.1.8 The hearing of evidence related to the Application was held on January 8 and 9, 1997. At the conclusion of the hearing, Board Staff did not present argument but presented a summary of the issues. The Companies' Argument-in-Chief was presented orally on January 13, 1997. Intervenors' written argument was required to be filed by 9:00 a.m. on January 13, 1997 with the Board and the Companies. Written Arguments were filed by the Industrial Gas Users Association, The Consumers' Gas Company Ltd., Natural Resource Gas Limited, PanEnergy Marketing Limited Partnership, and Pollution Probe Foundation. Oral Arguments were presented on January 13, 1997, by the Consumers Association of Canada, Ontario Coalition Against Poverty, Energy Probe Research Foundation, The Corporation of the City of Kitchener, and Canadian Industry Program for Energy Conservation. Novagas Clearinghouse Ltd. filed a letter supporting the Application. Reply Argument was presented orally on the same date.

1.1.9 The Board received letters commenting on the Application from the following Municipalities:

- The Corporation of the City of Chatham ("City of Chatham")
- The Corporation of the Township of Sidney
- Village of Iron Bridge
- The Township of Dawn
- The Town of Thornbury

1.1.10 No letters were received opposing the Application. The City of Chatham requested certain undertakings which are dealt with later in this Report.

1.1.11 Copies of the evidence, exhibits and submissions in this proceeding, together with a verbatim transcript of the hearing, are available for public review at the Board's offices.

1.2 INTERVENTIONS AND WITNESSES

1.2.1 The following were parties to the hearing. Not all parties cross-examined or submitted argument.

The Companies	P. Jackson
Board Staff	J. Lea
Consumers Association of Canada ("CAC")	R. Warren
Industrial Gas Users Association ("IGUA")	B. Carroll
Ontario Coalition Against Poverty ("OCAP")	M. Janigan
The Consumers' Gas Company Ltd. ("Consumers Gas")	F. Cass
Pollution Probe Foundation ("Pollution Probe")	M. Klippenstein
Energy Probe Research Foundation ("Energy Probe")	M. Mattson
PanEnergy Marketing Limited Partnership ("PanEnergy") Natural Resource Gas Limited ("NRG") Direct Energy Marketing Limited ("Direct")	P. Budd
Corporation of the City of Kitchener ("City of Kitchener")	E. Holmes
Coalition of Eastern Natural Gas Sellers ("CENGAS")	R. Perdue
Ontario Association of Physical Plant Administrators ("OAPPA")	M. Morrison

Canadian Industry Program for Energy Conservation ("CIPEC")	B. Symes
Novagas Clearinghouse Ltd. ("Novagas")	G. Pratte
TransCanada PipeLines ("TCPL")	M. Samuel
A. E. Sharpe Limited ("Sharpe")	G. Villanueva
Westcoast Gas Services Inc. ("WGSI")	P. French

1.2.2 Westcoast, Union and Centra called the following employees as witnesses. Unless otherwise indicated, they are employees of Centra and Union.

J. Bracken	Vice-President Marketing, Storage and Transportation
P. Elliott	Manager of Rates and Cost of Service
R. Battista	Manager of Special Projects
J. Woodruff	Vice-President Controller
W. Bingham	Vice-President, Finance and Treasurer, Westcoast

1.2.3 The Board has considered all the evidence, submissions and arguments adduced at the hearing and has summarized the evidence and positions of the parties only to the extent necessary to clarify the issues on which the Board has made specific findings.

1.2.4 The structure of the Report is as follows: Chapter 2 summarizes the evidence filed by the Companies and adduced at the hearing. Chapter 3 summarizes the positions of the parties who submitted argument. Chapter 4 sets out the Board's findings and recommendation with respect to the request to amalgamate Union and Centra. Chapter 5 deals with the changes to the Undertakings that are recommended should

the LGIC approve the amalgamation. Chapter 6 contains the Board's decision on the Companies' request for an accounting order to defer the one time costs associated with the implementation of the amalgamation. In Chapter 7 the Board sets out its findings on cost awards for this proceeding.

2. THE MERGER PROPOSAL

2.1 BACKGROUND

2.1.1 In April 1990 Westcoast purchased ICG Utilities (Ontario) Inc. (now Centra) from ICG Canada Inc. As part of the process of obtaining the LGIC's approval for the purchase there was a hearing before the Board. In its E.B.R.L.G. 34 Report to the LGIC on the takeover of ICG Utilities (Ontario) Inc., the Board recommended certain conditions for the approval and that these conditions be established in a set of undertakings between the Companies and the LGIC. Westcoast, certain affiliates and Centra entered into undertakings ("the Centra Undertakings") with the LGIC as part of the approval under section 26 of the OEB Act. The Centra Undertakings make provisions for a number of matters related to the relationship between Centra and its affiliates, specifically its parent.

2.1.2 In 1992 Westcoast negotiated a purchase of Union Energy Inc., the parent of Union, from Unicorp Inc. That takeover was not subject to a public hearing or report of the Board, because the takeover did not meet the requirements of section 26 of the OEB Act, or the provisions of the Undertakings that Unicorp and Union had given to the LGIC at the time of that takeover in 1988. However, undertakings were negotiated between the LGIC and Westcoast, its affiliates and Union ("the Union Undertakings"). These Union Undertakings make provision for similar matters to those of the Centra Undertakings. A key commitment of the Union Undertakings is the requirement that Union and Centra be managed as separate businesses.

2.1.3 In 1994 Centra and Union applied to the Board for approval to enter into a shared service arrangement such that a number of functions would be managed and delivered to the utilities on a shared basis. The proposal also envisioned a shared executive group. The plan for shared services was expected to generate annual savings for the two utilities of approximately $15 million. The Companies' reasoning for the proposal was to gain administrative and operational efficiencies by reducing duplication. The Board approved the required exemptions from the Undertakings for Centra and Union in its E.B.R.L.G. 34-12/E.B.O. 177-06 Report dated August 24, 1994. During the following rate hearings for the respective utilities, the Board heard evidence and considered the costs and benefits of the shared services arrangements in January 1995. Annualized savings at that time were identified at $15.6 million, one time operating expenditures at $11.7 million, and net capital expenditures at $4.0 million. The Board's Decisions in E.B.R.O. 486/E.B.R.O. 489 approved the forecast costs and benefits of shared services for inclusion in rates.

2.1.4 According to the Companies in this proceeding, the merging of Centra and Union was an objective that pre-dated the shared services initiative. However, there were a number of identified constraints that precluded a merger at that time. These constraints were identified as the differences in accounting methodologies for income taxes and the differences in the capital structure of Centra and Union. Also, certain cost allocation and rate design issues had to be addressed.

2.1.5 Centra and Union use different accounting methodologies for income taxes. Centra uses a flow-through method which is the standard for most utilities in Canada. Union uses the deferred-tax method. At the time of the shared services proceeding, the Companies noted that the inconsistency in tax treatment would have to be addressed if a merger were to take place. A related factor which needed to be addressed was the different capital structures for ratemaking purposes for the two utilities. Currently, Centra's common equity component is deemed at 36% which is considerably higher than Union's at 29%.

2.1.6 On March 27, 1996 Centra and Union applied to the Board for new rates effective January 1, 1997. The Board gave these applications file numbers E.B.R.O. 493 and E.B.R.O. 494, respectively. The Board combined the two applications in one

proceeding. As this was the first hearing on rates since the implementation of the shared services arrangement, one of the issues the Board included for consideration in the hearing was the issue of the allocation of costs between the two utilities. The result of the shared services initiative was also an issue.

2.1.7 As part of its application, Union proposed to increase the deemed common equity component of its capital structure to 35%, and to change to the flow-through methodology for tax accounting. With respect to the accumulated balance of $262 million in the deferred tax account relating to its regulated business, Union proposed an amortization method beginning in 1997.

2.1.8 Part of the hearing process involved a settlement conference or Alternative Dispute Resolution process ("ADR"), in which the parties to the proceeding attempted to settle issues prior to the hearing. The parties to the E.B.R.O. 493/494 proceeding reached a settlement on many issues through the ADR process. In the settlement conference the parties agreed to Union's proposed change in the tax methodology and its proposed amortization of the deferred tax amount. They also agreed to a 1997 deemed common equity component of 34% for Union. The hearing of the evidence concluded at the end of November 1996, and argument was received in December. The Board's decision on the rates applications, including its assessment of the ADR Agreement, is pending.

2.1.9 Also during the hearing of the rates applications, the Board considered a request by the Companies for exemption from the affiliate transaction commitments in the Union and Centra Undertakings for the purpose of allowing the utilities to pay certain charges to Westcoast. The charges are for services to be provided to the utilities in 1996 and 1997 by the Westcoast Corporate Centre. These services include a number of administrative and finance related functions that are proposed to be provided at a corporate level to all of Westcoast's subsidiaries. The decision on these requests for exemption is also pending.

2.1.10 The Companies stated in their evidence in the merger proceeding that, should the Board in E.B.R.O. 493/494 not accept the agreed upon capital structure and change in tax accounting, it would need to reconsider its plans for the merger.

2.1.11 The present application and hearing represents the third stage in the process of combining these two natural gas distributors. In the present proceeding, the issues focused on impacts from amalgamating the two companies, in areas such as rate design and cost allocation. It was not necessary to review in depth issues relating to competition and market concentration because of the common ownership of the Companies.

2.1.12 Under section 26 of the Act, the Board's task is to report its opinion to the LGIC on the proposed merger. Although not specifically stated in the enabling legislation, the opinion of the Board is invariably based on a consideration of the public interest.

2.2 CORPORATE STRUCTURE

2.2.1 The current organizational structure of the Westcoast group of companies including Centra and Union is shown in Appendix A. Centra and Union are direct subsidiaries of different holding companies.

2.2.2 The proposed post-amalgamation organizational structure is shown in Appendix B. The merged company will be 100% owned by Centra Gas Inc., which is the company that currently directly owns Centra. The common shares of Union will be transferred from Union Energy Inc. to Centra Gas Inc. According to the evidence, the major function of Centra Gas Inc. is the holding of the shares of the subsidiaries.

2.2.3 Neither Centra nor Union will be dissolved. The merged company will be a continuing corporation with the same rights and obligations as currently exist in Centra and Union.

2.2.4 The evidence was that approval would also be required from the Ontario Securities Commission ("OSC") before the merger is effected. The OSC requires, under its Policy 9.1, certain valuations in respect of related party transactions unless an exemption is granted. The valuations are intended to ensure that all security holders are treated fairly. The Companies expected that they should be able to obtain an exemption given that the shares are not publicly traded and are essentially held by one

corporate entity. In any event, the Companies did not foresee any impediments in obtaining OSC approval.

2.2.5 With regard to the franchise agreements which each utility has with the municipalities it serves, only the consent of the City of Hamilton is required, and that has been received.

2.2.6 Both Centra and Union have trust indentures related to their issuance of debentures. These trust indentures provide protection for the debenture holders by setting out restrictions on the utilities with regard to, among other things, changes in ownership or an amalgamation. The Companies in evidence indicated that they expected approval of the amalgamation by the Trustees for each of the utilities' Indentures.

2.2.7 With respect to Union's debenture holders, the evidence was that the conditions of the Principal Indenture to allow the merger do not appear to be an impediment. There are no financial tests that must be satisfied immediately following the merger. The Principal Indenture of Union includes provisions for amalgamation and continuance of the indentures by a successor company. The Principal Indenture permits amalgamations where the successor company is a Canadian company, where it assumes liability for the obligations of Union, and where Union and the successor company satisfy the Trustee that the amalgamation will not affect the ability to honour the Indenture.

2.2.8 Centra's Indenture requires similar terms for the amalgamation. However, the Indenture also sets out several financial soundness tests relating to the ability of the successor company to fulfil payment of the obligations under the Indenture. The evidence of the Companies was that the merged company would meet all the relevant tests and therefore the Trustee would have no reasonable grounds for objecting to the amalgamation. With respect to Centra's debenture holders, the Companies had not identified any concerns regarding the conditions specified in the applicable Indenture. It will, however, be necessary to determine whether the merged company would satisfy certain interest coverage and capitalization tests. The evidence was that these tests would be satisfied and it would not be necessary to seek any debenture holder approval.

2.2.9 With respect to the holders of preference shares there is an issue as to the relative seniority of the preferred shares of the two companies. The evidence was that Centra will redeem its preferred shares in accordance with the applicable preference share agreements. The total premium related to the redemptions was forecast to be $38,000.

2.3 BENEFITS

2.3.1 The Companies forecast annualized savings from the merger of approximately $2.1 million, after absorbing one time costs and allowing sufficient time to implement the programs that would generate the savings. The savings stem from not having to maintain two legal entities, thereby reducing duplication in planning and administrative activities, including regulatory costs.

2.3.2 The anticipated annual savings would arise in the following areas:

Operations	$ 625,000
Finance	370,000
Treasury	336,000
Regulatory	200,000
Gas Supply	58,000
Insurance and Licences	283,000
Other administrative savings	250,000
Total Savings	$2,122,000

2.3.3 The full $2.1 million in savings would be realized by the year 2000. The savings in 1998 are projected at $1.7 million and in 1999 at $2.0 million.

2.3.4 A description of the components of the forecast savings is provided below.

Operations

2.3.5 The forecast $625,000 savings in Operations result from the elimination of seven positions as combining franchise areas will allow the use of common management and support staff in some regions of the merged company's operations. The full amount of these savings would be realized in 1998, the first year of the merger.

Finance

2.3.6 Of the forecast $370,000 savings in Finance, approximately $260,000 result from the elimination of four positions due to reduced activity in accounting, financial reporting, and forecasting. The remaining savings are due to auditing one entity rather than two ($75,000), a reduction in banking service charges ($25,000), and filing a single corporate tax return ($10,000). The full impact of the savings in Finance would be realized in 1999; $232,000 would be realized in 1998.

Treasury

2.3.7 Of the total $336,000 in forecast savings in Treasury, the majority ($170,000) would result from the use of Union's less costly commercial paper borrowing program rather than Centra's bankers acceptances. The remaining savings will be from: lower costs for a new debt issue planned for Centra in 1999 ($25,000); larger and less frequent access to capital markets for the merged company ($40,000); reduced costs for filing fees and preparation costs for annual reports, security commissions' filings, and rating agencies' reports, because the merged company can file as a single entity ($57,000); and reduced fees for security regulation and reduced frequency of publication for preferred share dividend notices ($44,000). The full $336,000 in savings would be realized in 1999; $265,000 would be realized in 1998.

2.3.8 The Companies provided a preliminary assessment from Canadian Bond Rating Service ("CBRS") and filed a letter from Dominion Bond Rating Service ("DBRS"). Both of these agencies indicated that, in their view, the proposed merger would have no negative impact on the credit ratings of the merged company compared to the existing ratings for Union and Centra.

Regulatory

2.3.9 The anticipated $200,000 savings in regulatory costs would result from reduced rate hearings beginning in 1999 after the first rates hearing on a merged company basis is completed.

Gas Supply

2.3.10 The projected $58,000 savings in Gas Supply would be a result of efficiencies in tracking gas acquisitions and transportation contracts, in billing, and the use of a single gas planning model. The full impact of these savings would be realized in 1998.

Insurance and Licences

2.3.11 Of the total $283,000 anticipated savings in Insurance and Licences, the majority ($208,000) would result from lower premiums expected for a larger single entity, and the balance ($75,000) would be due to the elimination of Centra's distribution licence fee payable to the Ministry of Consumer and Commercial Relations. All of these savings would be realized in 1998.

Other Administrative Savings

2.3.12 The Companies expected a further $250,000 savings in general administration including: the payment of lower fees to industry associations; the use of a single logo, letterhead and business cards; the generation of single internal reports; and the use of single contracts with customers and suppliers. These savings would be realized in 1998.

Additional Benefits

2.3.13 The principal reason given by the Companies for approving the amalgamation was the forecast of approximately $2.1 million annual savings in Operating and Maintenance expense. The Companies explained that the savings related to the elimination of duplication in administration and operational efficiency savings. The administrative

savings result from eliminating the duplication related to maintaining two separate legal entities.

2.3.14 The Companies expected that the merger would provide opportunities for customers to obtain new services and increased flexibility in the existing services. Centra customers will be able to access Union's significant storage assets as in-franchise customers. The Companies expected that, for the most part, the new services would be for only the large industrial customers who manage their own loads and require flexibility in the use of storage for load balancing. Increased flexibility was also anticipated for interruptible customers. It was not anticipated that small volume customers would see many new services as a result of the merger. The Companies also testified that the merger would create a more competitive entity in terms of its ability to attract new customers and increase throughput.

2.4 COSTS

2.4.1 The Companies forecast $1,982,000 in one time operating and maintenance ("O&M") costs to effect the merger. A summary of these costs is as follows:

Regulatory	$ 600,000
Finance and Legal	425,000
Relocation and severance	450,000
Name implementation	390,000
Employee and customer communications	55,000
Miscellaneous and contingency	62,000
Total One time O&M Costs	$1,982,000

2.4.2 Of the total one time costs, $236,000 were incurred in 1996, $801,000 are anticipated to be incurred in 1997, and the balance of $945,000 in 1998.

2.4.3 The Companies suggested that the one time costs be deferred and amortized over two years in a manner such that, overall, rates are not negatively impacted as a result of the merger. In that regard, a separate application was made to the Board on January

8, 1997 for an accounting order with the request that the matter be dealt with as part of this proceeding.

2.4.4 A description of the one time O&M costs is provided below.

Regulatory

2.4.5 Of the forecast $600,000 in regulatory costs, $400,000 are due to intervenor, legal and Board costs for the merger hearing. The $200,000 balance is for purchasing a cost allocation model ($25,000) and for consulting costs to assist Centra and Union with cost allocation issues. The evidence was that $167,000 of the total costs have been incurred in 1996, $383,000 would be incurred in 1997, and $50,000 in 1998.

Finance and Legal

2.4.6 Of the forecast $425,000, $175,000 are for legal fees, and the balance of $250,000 for Treasury costs. Legal fees include: a review of organizational issues; the preparation of articles of amalgamation, by-law resolution and indentures; the resolving of Trustee issues; and the application to the OSC. Treasury costs include: registrar and transfer agent fees; financial restructuring costs; investor communication costs; and banking fees. The evidence was that these costs included an amount of $100,000 in legal costs to be incurred by Westcoast. Of the total $425,000 in costs, $57,000 have been incurred in 1996 and the balance of $368,000 would be incurred in 1997. The evidence indicated that of the total $425,000, an amount of $200,000 was included as a contingency.

Relocation and Severance

2.4.7 The expected $450,000 relocation and severance costs relate to eleven position redundancies identified as a result of the merger. It is expected that all of these costs would be incurred in 1998.

Name Implementation

2.4.8 Of the $390,000 in forecast costs for introducing the merged company's name in the Centra franchise area, $250,000 relate to vehicle decals. The balance of $140,000 relates to changing pipeline and building signs. All of these costs would be incurred in 1998.

Employee and Customer Communications

2.4.9 The forecast $55,000 costs for employee and customer communications include those for meetings with municipal officials, employee newsletters and customer bill inserts. Of the total costs, $12,000 have been incurred in 1996, $38,000 are expected to be spent in 1997, and $5,000 in 1998.

Miscellaneous and Contingency

2.4.10 Of the proposed $62,000, $12,000 relate to gas supply contract changes, supplier notifications and licensing agreements. It is expected that these expenditures would be made in 1997. The remaining amount of $50,000 is a contingency provision for legal costs in 1998, over and above the $200,000 contingency amount included in 1997 for Finance and Legal costs.

Capital Costs

2.4.11 The evidence was that approximately $925,000 in capital costs would be needed to effect the merger. Of these costs, $650,000 would be required for computer systems to reconfigure the financial reporting for the merged company. The balance of $275,000 is an estimated expense for instituting the required flexibility in the single gas control system needed to manage the gas nomination and movement that is unique to each franchise area. The total capital costs of $925,000 would be proposed for inclusion in the rate base of the merged company at the time of setting rates for the 1998 fiscal year.

2.5 RATES

2.5.1 The one remaining issue identified as a factor in merging the utilities is the difference in cost allocation and rate design between the two companies. Centra and Union proposed to file at the next rates case dealing with the 1998 fiscal year, studies which would identify the differences in the cost allocation methodologies for the two utilities and proposals for possible integration of the two methodologies.

2.5.2 With respect to rate design, the utilities stated that they will use the following principles or guidelines:

1. *All customer classes should be better off as a result of the merger through lower rates, the availability of additional services, or increased flexibility.*

2. *Rate levels, for both supply and delivery, will not be common for Centra and Union customers, except where the rates are sufficiently close enough to allow commonality. The rate levels will continue to reflect the cost to serve the respective geographic areas. Some of the costs of the infrastructures required to serve the Centra and Union franchise areas, such as the costs associated with TCPL delivery zones, are sufficiently different to preclude common rates in the near future.*

3. *Common rate structures, customer classifications, services, administrative practices, and terms and conditions of service will be developed to the extent possible. For example, the blocks within the residential rate schedule may be made common. The utilities anticipate that such commonality, where possible and proper, may require approximately 3 years to complete.*

3. POSITIONS OF THE PARTIES

General

3.0.1 Unqualified support for the amalgamation was given by Energy Probe, IGUA and Novagas. These parties noted that the Board was not being asked to approve specific changes in cost allocation and/or rate design and that the effect of the amalgamation on these issues would be tested in the merged company's subsequent rates cases.

3.0.2 Energy Probe argued that the amalgamation would not have an anti-competitive impact on other competitive areas of the energy business. They stated that customers will benefit from a single large natural gas distribution system and that distribution operations will continue to be regulated.

3.0.3 Energy Probe also argued that the fact that all of the proposed savings are in O&M demonstrates that not all the potential benefits of amalgamation are being achieved. Energy Probe submitted that the regulatory process penalizes shareholders for rate base efficiencies and that further rate base efficiencies could be made in the billing system, reduction in office space and equipment and reductions in storage assets requirements if incentive regulation were employed.

3.0.4 Qualified support to the proposal was given by CAC, CIPEC, Consumers Gas, NRG and PanEnergy.

3.0.5 CAC stated that, while the Companies did not meet the test of positive results to all customers at a sufficient level of certainty, CAC is prepared to accept that the Companies can meet that test.

3.0.6 CAC noted that of the three critical issues to preventing amalgamation identified by the Companies, the first two — differences in capital structure and tax accounting methodology — were agreed upon by parties to the E.B.R.O. 493/494 ADR. However, they argued that the third constraint - cost allocation and rate design - requires a new cost allocation study and this was not done and therefore the Board "cannot know with sufficient certainty that residential consumers will benefit from the merger or even that they will not be harmed." In this respect the CAC saw the application as premature.

3.0.7 CAC also argued that the risk to residential customers could be controlled by applying three conditions: (1) the Company apply the rate design guidelines articulated in its evidence and that separate rate structures be maintained if necessary; (2) as a protection for residential customers the cost of the amalgamation should be borne by the shareholders; and (3) that no deferral account be created to book the costs of the amalgamation.

3.0.8 CIPEC did not oppose the application. It noted, however, that, in light of the *"de minimis"* annual savings, parties were being asked to "buy into" a cost allocation and rate design process which parties do not understand and do not have before them.

3.0.9 Consumers Gas, a transportation and storage customer of Union, supported the merger on the basis that certain savings are expected for such customers.

3.0.10 NRG, a wholesale customer of Union, supported the merger, noting that there will be no impact on customers in its class, since Union's wholesale rate is generally a gas supply, storage and transportation service.

3.0.11 PanEnergy, a natural gas marketing company, stated that it is satisfied that the merger will not disadvantage direct purchase customers. It expressed the hope that the amalgamation will have positive effects by providing some additional ability to

perform gas supply diversions between the different franchises and may eliminate or ease some of the capacity constraints that exist on the Centra system.

3.0.12 OCAP, while in support of the merger, took issue with some of the specific claimed savings and costs, particularly in the context of the Westcoast Corporate Centre charges being considered in the rates hearing.

3.0.13 The City of Kitchener did not support the application on the basis that the cost allocation issues associated with the future disposition of the deferred tax balance are not satisfactorily dealt with.

3.0.14 The positions of the parties on some of the specific issues on the application are set out below.

Public Interest

3.0.15 While no party provided specific definitions as to what constitutes the public interest a number of parties did comment on the nature of the test that the Board should apply.

3.0.16 CIPEC argued that the public interest test the Board should employ must be a positive one, and that finding the amalgamation was not detrimental to the public interest was not sufficient. CIPEC noted that the evidence only addressed what effect the amalgamation would have on the customers of Centra and Union. They also expressed scepticism with the Companies' claim that there will be benefits for customers, noting that no new services were identified for residential customers and the only potential industrial benefit was in the area of load balancing and additional storage. CIPEC argued the Board should be cautious in its report to the LGIC because of the very limited nature of the evidence.

3.0.17 CAC argued that the test should be that there is no proven harm to the public interest. They did not believe the evidence supports the case that the amalgamation will be beneficial for residential customers, but believed there was no evidence that in the long-run the public interest will be harmed.

3.0.18 The City of Kitchener stated that if the public interest is determined only by whether there are net savings as a result of the merger, then the amalgamation is clearly in the public interest as there are no concerns about security of supply or quality of service. It went on to argue against the merger on other grounds.

Deferred Tax Issue

3.0.19 Consumers Gas, NRG and the City of Kitchener expressed concern with respect to the future allocation of Union's deferred tax balance. The City of Kitchener argued that if the Board does not know the disposition of the deferred tax balance it cannot know if Union's customers will be better off and cannot pronounce on the public interest.

3.0.20 The City of Kitchener stated that "[I]n the absence of a merger, the future disposition would be limited to the storage, transportation and distribution customers of Union. However, if a merger takes place, then the claims of the distribution customers of Centra are created." The City of Kitchener believed that this possibility would get stronger as time goes on as there will be a trend toward commonality in rates.

3.0.21 NRG argued that the merger may affect the allocation of deferred tax balance to Centra's distribution function, but not the storage and transportation. NRG expressed similar concerns to those of the City of Kitchener, but supported the application based on the understanding that the deferred tax balance will accrue to its rate class in the same magnitude regardless of whether or not the merger occurs.

3.0.22 Both NRG and Consumers Gas asked that the Board order the necessary separation of records with regard to deferred tax balances. Consumers Gas extended their request for separate records to include the allocation units on the Dawn-Trafalgar system and a study on unaccounted for gas as specified in the ADR Agreement in E.B.R.O. 493/494.

Undertakings

3.0.23 Pollution Probe supported the inclusion in the combined Undertakings of Union's commitments with respect to research and development and aggressive promotion of energy efficiency. Pollution Probe also submitted that the paragraph 5.1 dealing with affiliate transactions should be changed. It currently reads:

> *Other than the sale, transportation and storage of gas by Mergeco in the ordinary course of business, any Affiliated Transaction aggregating $100,000 or more annually shall require prior approval of the Ontario Energy Board, which approval shall not be withheld if the transaction is shown to be of benefit to Mergeco and not to the detriment of any of its customers* ***or*** *if a purchase takes place at or below fair market value or if a sale takes place at or above fair market value.*

3.0.24 Pollution Probe submitted that the term "or if" creates two alternative grounds for approval, and proposed changing the wording "**or** if" to make the two criteria joint by replacement of the words with "**and** if".

Cost of the Merger

3.0.25 CIPEC stated that, given the *de minimus* nature of the savings, and the largely speculative nature of the benefits of the amalgamation, the costs should be borne by the Companies' shareholder.

3.0.26 CAC and OCAP also argued that the costs of the amalgamation should be borne by the shareholder. In OCAP's submission ratepayers should not bear the cost of the merger as the absence of a cost allocation proposal means that the forecast stream of benefits have a high degree of uncertainty attached to them. It also argued that there may be shareholder benefits through increased competitiveness of a merged company and that Westcoast would receive these benefits at no cost. Similarly, CAC argued that the risk that customers will receive a benefit for which they have not paid is equal to or greater than the risk that the costs residential customers will have to bear may outweigh the benefits of the proposal.

3.0.27 Energy Probe disagreed that the benefits accruing as a result of the amalgamation are not well documented in the evidence and may be uncertain. It cited as examples of greater efficiencies one rate hearing, issues related to cost of capital and organizational efficiencies. Energy Probe submitted that there were no additional annual costs that would result as part of the merger, other than the one time costs provided in the evidence.

Deferral Account/Amortization

3.0.28 OCAP submitted that costs of the amalgamation already incurred are primarily regulatory costs and should have been forecast for inclusion in 1997 rates. Since the Companies choose to proceed without prior rate approval, OCAP argued they should be responsible for the costs. Therefore no deferral account was necessary to capture the costs of the amalgamation. In the alternative treasury and legal costs should be excluded as they are "duplicative of functions of the [Westcoast] Corporate Centre." OCAP argued that the costs associated with changing to a single name should not be allowed because Westcoast is the primary beneficiary of this action.

3.0.29 CAC argued against the creation of a deferral account because it would result in increased risk to residential customers as they may be required to bear some of the cost of the amalgamation.

3.0.30 NRG and IGUA supported the proposal for a deferral account. IGUA also argued that the amortization of one time expenses over two years is consistent with the principle that expenses should be charged in such a manner as to avoid any increase in the rates of the merged company.

Companies' Reply

3.0.31 As to the appropriate public interest test to be used, the Companies pointed out that in E.B.R.L.G. 35, *The Board's Report to the LGIC on the Acquisition of Consumers' Gas by British Gas plc,* the test was a negative, or "no harm" test. The Companies stated that they accept that test but urged the Board to find the merger is in the public interest.

3.0.32 The Companies, in responding to the concerns that details of cost allocation and rate design were not part of the proposal, noted that rates will continue to reflect the differing costs of service in the geographic areas. The Companies stated, that had they concluded that one common set of rates was the appropriate direction for the merged company, then the application would have been deferred until the consequences of that policy had been assessed. They also submitted that the current cost allocation and rate design could be maintained if that were deemed desirable.

3.0.33 In the Companies' submission the Board could manage any incremental cost allocation and rate design changes when they are proposed. They noted that they had been very clear about what principles should apply to the development of a cost allocation and rate design methodology. The Companies argued that the incremental approach had the benefit of allowing the Board and parties more direct input into cost allocation and rate design changes.

3.0.34 The Companies argued that while the principles articulated with regard to cost allocation and rate design were important, they were not guarantees of the absence of future rate impacts. Other factors which may operate over time, such as proper cost causality and the impact of a dynamic and changing marketplace, could not be ignored. Nevertheless, the Companies considered the range of uncertainty to be manageable.

3.0.35 The Companies suggested that the disposition of Union's deferred tax balance was illustrative of how uncertainty could be managed. They noted that deferred taxes are attached to the assets that gave rise to them and will be allocated on the basis of cost pools associated with those same assets. In this regard, they noted that Centra's customers, through the purchase of storage and transportation services, have contributed to the build-up of the deferred taxes and with or without the merger would be expected to participate in the drawdown of the balances related to those functions. Centra and Union agreed to continue to track the information as sought by Consumers Gas.

3.0.36 The Companies submitted that OCAP's position that the costs of the amalgamation should have been forecast in the E.B.R.O. 493/494 rates case, and therefore should

be borne by the shareholder, should not be accepted. Had the costs been forecast for the rates case, the merger costs might have appeared in rates before the merger had been approved. The Companies argued that this would have been inappropriate since the Board needed the opportunity to examine the actual costs and address the principle of matching the costs of the merger to its benefits. They also noted that the amalgamation application was procedurally consistent with the shared services proceeding and other cases where one time costs are incurred for future benefits.

3.0.37 The Companies rejected OCAP's suggestion that double counting might occur because the costs of the amalgamation are included in the Corporate Centre charges. Such a determination would require detailed evidence such as that submitted in E.B.R.O. 493/494 and not the selective Corporate Centre evidence examined by OCAP in this proceeding. In any event, the Companies submitted that corporate charges relate to the ongoing O&M budget of the utilities and not the extraordinary one time costs of the amalgamation.

3.0.38 The Companies argued that having the shareholder bear the one time costs of amalgamation would deny them a fair rate of return and provide a disincentive to pursue further savings. They objected to OCAP's suggestion that costs associated with changing the name of the company would benefit the shareholder, arguing that customers are entitled to know the name of the company that is serving them. The Companies also argued that the proposition that the merger is advantageous to the shareholder was based on speculation as to future changes to the non-monopoly businesses of the utilities.

3.0.39 The Companies argued that the proposed treatment of the one time costs in this case is analogous to that in the shared services proceeding and that there was no suggestion in that proceeding, where the savings were much larger, that the shareholder should bear the costs.

3.0.40 In response to Energy Probe's arguments that there were no rate base efficiencies the Companies noted that these types of savings were previously achieved under the shared services initiative.

3.0.41 In response to Pollution Probe's concerns with the wording in the Undertakings regarding affiliate transactions, the Companies stated that they had no objection in principle to replacing “or” with “and". However, they noted that the Board does have other means of reviewing affiliate transactions by virtue of its examinations of the utilities' cost of service in rates cases and through ongoing monitoring by the Board's Energy Returns Officer.

4. BOARD FINDINGS AND RECOMMENDATION

4.1 THE PUBLIC INTEREST

4.1.1 As stated earlier, in reporting to the LGIC on the proposed merger, the Board bases its opinion on a consideration of the public interest.

4.1.2 In reaching its conclusion, the Board uses certain general parameters it has formulated over the years as a guide in assessing the overall public interest. The relative importance of each of these parameters can vary and has varied from one situation to another, but in general they form the basis for the Board's opinion in examinations of this type. In this specific application, the parameters can be stated as follows:

1. Impact on rates and service,
2. Interest of shareholders and impact on investors,
3. Impact on employees,
4. Impact on communities,
5. Regulatory implications,
6. The public interest generally.

Impact on Rates and Service

4.1.3 The Companies forecast financial benefits of $1.7 million in the first year (1998) increasing to $2.1 million in the third and subsequent years. The one time O&M costs were forecast at $2.0 million and one time capital costs at $0.9 million.

4.1.4 The Companies contended that there would be additional benefits for customers in the form of additional services and increased flexibility.

4.1.5 The Board notes that no party took issue with the proposed merger on the basis of the net savings to ratepayers. From an overall cost effectiveness perspective, the Board accepts that the merger will reduce the overall revenue requirement of the merged company. The forecast savings appear achievable and may well be exceeded as the merger matures. In particular, the Board considers that the cost of capital may be reduced in the merged company as a result of, as CBRS points out in its preliminary assessment, a larger customer base, a wider geographical area having different weather patterns and a more diverse economy and customer mix. In this regard, the Board notes that CBRS anticipates a future upside credit potential. DBRS does not anticipate any negative impact on the present ratings.

4.1.6 The Board also considers that more operational efficiencies may be achieved as a result of other synergies which may not be obvious at this early stage.

4.1.7 During cross-examination, it was suggested that, unless benchmarking were introduced, there would be difficulty in the future ascertaining that the forecast savings have been realized. The Board has noted these concerns, but it does not view it to be practical or cost effective for the merged company to undertake what would amount to another layer of reporting complexity. In the Board's view, the areas in which these savings are expected to be realized are sufficiently clear for future regulatory scrutiny.

4.1.8 The one time O&M and capital costs forecast by the Companies appear reasonable for effecting the merger and are moderate in comparison to the perpetual savings. The costs to be reflected in rates will naturally undergo scrutiny by the Board in future

rates hearings. The Companies must be prepared to demonstrate that all of these costs should be recovered from ratepayers.

4.1.9 The main issue from the perspective of certain parties was that the Companies have not presented a definitive plan or proposal for the harmonization of cost allocation methodologies and rates. It was the evidence of the Companies that they are in the process of determining the differences in the methodologies of cost allocation between the two companies and they will report on these differences and their proposals to accommodate those differences in future rates cases. For the next year at least, it is not expected that there would be material cost allocation and rate design changes arising specifically from the merger. In this regard, the Board notes that rates in the merged company will continue to reflect geographic differences until such time as the merged company puts forth specific proposals for Board approval. Overall, the Board is satisfied that the cost allocation and rate design concerns expressed by certain parties can be addressed in future rate proceedings.

4.1.10 A related but distinct concern was the potential sharing of benefits from Union's utility related deferred income tax balance of some $262 million by Centra's customers. The amortization of the balance is proposed to be completed in 15 years starting in 1998.

4.1.11 The Board observes that while the amortization of Union's $262 million in deferred taxes will provide a benefit to ratepayers, there will also be offsetting changes to rate base and capital structure.

4.1.12 The Board notes that it is the intention of the Companies to ensure, to the degree possible, that whatever benefits result from the amortization of the income tax balance, they accrue to the benefit of those customers who have contributed to its accumulation. While there are some uncertainties created in the exact identification of these customers in the future, and an inherent inability to exclude, for example, new distribution customers in the former Union franchise area from participating in the benefits resulting from the amortization, the Board considers that the uncertainties created are manageable and that the inherent difficulties would exist regardless of any merger.

4.1.13 With respect to the claim by the Companies that the merger will provide additional services and increased flexibility to customers, the Board accepts that this will likely be the case for certain customers, particularly in the large industrial group. While there was limited evidence as to specific additional services or flexibility resulting from the proposed merger, there was no evidence that there will be harm to any customer group.

4.1.14 Gas supply matters received particular attention from some intervenors. The combined company will employ a single supply planning model beginning in 1998. Centra's current transportation and storage service demands will become in-franchise demands, so that Centra will not have to queue for Union's storage facilities. There will also be minor effects resulting from operational efficiencies in storage and in gas supply contracts which will likely increase flexibility on the new system. There was no evidence that direct purchase customers in general or interruptible customers in particular will be adversely affected under combined operations.

4.1.15 At the conclusion of the hearing no parties identified any unaddressed concerns that the proposed merger would adversely impact gas supply and direct purchase arrangements. The Board concurs.

Interest of Shareholders and Impact on Investors

4.1.16 The issues relating to common shareholders normally associated with changes of control were not present in this proceeding as common ownership of Centra and Union by Westcoast has existed for a number of years.

4.1.17 The Board continues to believe that, unless public interest considerations dictate otherwise, shareholders should be free to arrange their corporate affairs as they see fit.

4.1.18 The Board also notes that the proposed corporate structure of the merged company is not controversial. The Board found no evidence to suggest that the proposed corporate structure is specifically designed to confer an inordinate benefit to the

parent. The benefits of the proposed structure appear to be avoidance of creating tax liabilities, and preservation of the existing financial arrangements.

4.1.19 With respect to debenture holders and preference shareholders, the Board's interest is to ensure that investor relations are not negatively affected by the proposed merger, making investing in the merged company riskier and raising capital more costly.

4.1.20 The Board accepts the Companies' evidence that the conditions obviating debenture holder approval will be met.

4.1.21 Given the proposed redemption of Centra's preference shares, the Board finds that there is no outstanding issue relating to the relative seniority of Union's and Centra's preference shareholders.

Impact on Employees

4.1.22 It is anticipated by the Companies that the merger will result in the elimination of eleven positions. The total number of employees in the merged company will be approximately 3,330. The Companies' policy is to attempt to employ the affected individuals in other areas of the merged company. The evidence was that any relocation or separation packages would be consistent with those offered in the shared services initiative. The Board has not identified any material concerns relating to employee impacts.

Impact on Communities

4.1.23 Communities are served under franchise agreements that specify rights and responsibilities of the utilities and the various municipalities. The Board has not identified any concerns that these arrangements will be negatively affected.

4.1.24 The head office of the new company will be in Chatham at the existing offices of Union. The City of Chatham requested an undertaking that the head office and current functions of the head office remain in Chatham. The Board deals with this specific issue in Chapter 5.

Regulatory Implications

4.1.25 Fundamental changes to two large regulated companies must also be examined with a view to ensuring that the Board will be able to continue to discharge its regulatory mandate. There was no evidence and no party argued that the Board's responsibilities would be compromised as a result of the merger.

4.1.26 The current existence of three major gas utilities in Ontario is valuable to the regulatory process in that comparisons can be made among the utilities. On the other hand, the merged company will become more comparable to Consumers Gas, making comparisons in certain ways more meaningful.

4.1.27 The merger of Centra and Union will reduce the regulatory burden as a result of fewer rates cases and other applications. However, the Board anticipates that rate reviews of the merged company over the next few years will entail some unique complexities, particularly in the areas of cost allocation and rate design. The Board will need to be prepared to examine, in future reviews of the merged utility, possible effects which could not be presently identified.

The Public Interest Generally

4.1.28 As the Board has commented in previous cases, one of the problems in assessing the public interest is that a benefit to one group is often a detriment to another. The Board's role is to weigh all the benefits against all the detriments and decide in the overall public interest.

4.1.29 The Board has had many occasions to consider the public interest as an accommodation of conflicting interests. Some situations were highly contested, others less so. Other than certain future cost allocation and rate issues, what is notable in the present case is the absence of serious conflicting interests.

4.1.30 At the conclusion of the evidence, the Board asked the Companies whether they could provide more concrete assurances to the Board regarding cost allocation and rate matters upon which it could base a positive recommendation to the Government. The

Board accepts the Companies' position that the ongoing scrutiny of this Board through future regulatory proceedings, should provide sufficient comfort to the Board to support a positive recommendation to the LGIC.

4.1.31 The broader public interest also demands that the Board examine the proposed merger in a wider industry context. In this regard, the Board has not identified any potential problems or obstacles likely to be created by the proposed merger which may work against industry developments and goals. In an Ontario context, the Board had no evidence to suggest that inter-fuel competition and current reviews of restructuring of the utility industry along the lines of monopoly and non-monopoly businesses would be compromised in any obvious way.

4.1.32 Given the nature of the two firms to be merged, i.e. utilities with specific franchise areas not competing with each other, the typical concerns that arise from market concentration are not as applicable in this instance. For example, there is no issue whether market concentration in this case will restrict output or increase prices, or whether competition at the wholesale or retail level will be compromised. In any case, the two utilities are presently commonly owned and operated.

4.1.33 For a number of the parameters the Board examined, no harm has been found to result from the merger, and in some, positive benefits will result. Moreover, the proposed merger secures the savings that resulted from the shared services initiative by combining the two utilities. Overall the result is positive.

4.1.34 There was discussion at the hearing whether the Board should use the more stringent positive test of the public interest or the less stringent "no harm" test. The Companies commented that the proposed merger is in the public interest but the Board need not adopt this more stringent test in reporting to the LGIC. Others took the position that the test ought to be a positive one.

4.1.35 In view of the Board's positive conclusion regarding the benefits of the proposed merger, it is unnecessary for the Board to consider how confidently it would have recommended approval to the LGIC had the Board found the proposal met only the less stringent test.

4.1.36 The Board finds that the proposed amalgamation is in the public interest.

4.2 RECOMMENDATION

4.2.1 **The Board recommends to the LGIC that the proposed amalgamation of Centra and Union be approved, subject to the acceptance of the Undertakings as recommended by the Board.**

4.2.2 The Board's recommendation to the LGIC for approval of the merger application is irrespective of the Board's findings in the E.B.R.O. 493/494 relating to the capital structure, deferred tax matters, and Westcoast Corporate Centre charges, either in those rates cases or in future rates cases. Those are matters which are strictly rate related and will be decided on their own merits. The Board therefore has concluded that its findings are not dependent on the conclusions of the rates panel in E.B.R.O. 493/494, and has not viewed it to be necessary to wait for the outcome of these matters in the pending rates decision before it could make its recommendation to the LGIC.

4.2.3 Should the Board's decision in E.B.R.O. 493/494 cause any change in the plans of the Companies, it is expected that the Companies will advise the LGIC and the Board, prior to the LGIC granting approval.

4.2.4 The Board notes that approval by the Ontario Securities Commission is also required before the merger is legally effected, but the Board does not view it as necessary to condition its recommendation to the LGIC on that approval.

4.2.5 The Board's findings and recommendations with respect to the Undertakings that should be required of the merged company are set out in Chapter 5.

5. UNDERTAKINGS

5.0.1 Centra, Union and Westcoast are currently parties to certain Undertakings with the LGIC regarding the ownership and operations of the two Ontario utilities. Currently, certain differences exist in the Undertakings of the two utilities.

5.0.2 The original Centra Undertakings were given in 1990 and amended in 1992. They were further amended in 1996 to permit Centra to participate in bidding for business activities related to water and wastewater services within the Regional Municipality of Halton. The current Centra Undertakings are shown in Appendix C.

5.0.3 The original Union Undertakings were given in 1992. They were amended in 1995 and 1996 to allow participation in bidding for business activities related to water services for the Regional Municipality of York and the Regional Municipality of Halton respectively. The current Union Undertakings are shown in Appendix D.

5.0.4 Should the merger be approved, certain changes are required to produce a single set of Undertakings. The Companies provided a draft of the proposed Undertakings for the merged company and its owners. In drafting the proposed Undertakings, where a choice was made between the existing Undertakings, the choice and rationale for the selection were provided. The scope of the Companies' application did not include a proposed review of the substance of all commitments or exemptions contained in the Undertakings. The Companies' proposed Undertakings for the merged company ("Mergeco") are shown in Appendix E.

5.0.5 What follows is a summary of the Companies' proposed integration of the existing Undertakings and the Board's comments. The Board recommended Undertakings are shown in Appendix F. The LGIC approved Undertakings will have to incorporate the legal name of the merged company in place of Mergeco.

5.0.6 For purposes of its recommendations to the LGIC on the Companies' application, the Board has accepted the limited examination of the Undertakings proposed by the Companies. The Board's recommendations on the proposed Undertakings are, therefore, not based on an examination of the substance of every Undertaking. Rather, the Board's review was limited to the appropriateness of the proposed integration of the existing Undertakings. Where the Companies proposed to remove commitments or exemptions because they were no longer relevant, the Board concurred. The only exception to this is the Board's recommended removal of the exemption relating to the York Region Water Project.

5.0.7 There are currently certain commitments contained in Union's Undertakings which are not provided for in Centra's Undertakings. The Companies proposed to maintain the Union commitments in the merged company. What follows is a list of these commitments with which the Board is in agreement. The content of these Undertakings is set out in the Appendices.

- Auditors to report on Director Independence
  (Centra n/a, Union 2.2, Mergeco 2.2)

- Requirement for an Independent Board Committee
  (Centra n/a, Union 2.3, Mergeco 2.3)

- Independent Board Committee to Monitor Compliance with Undertakings
  (Centra n/a, Union 2.5, Mergeco 2.5)

- Board Audit Committee Requirement and Composition
  (Centra n/a, Union 2.6, Mergeco 2.6)

- Independent Committee to Approve Affiliate Transactions

(Centra n/a, Union 2.4, Mergeco 2.4)

- Equity Maintenance Termination
  (Centra n/a, Union 7.2, Mergeco 6.2)

- Research and Development
  (Centra n/a, Union 8.1-8.4, Mergeco 7.1-7.4)

- Energy Efficiency
  (Centra n/a, Union 9.1-9.2, Mergeco 8.1-8.2)

- Involvement
  (Centra n/a, Union 18.1, Mergeco 15.1)

5.0.8 Also, certain current commitments are identical, *mutatis mutandi*, for the two companies. Continuation of these commitments is proposed by the Companies, and the Board concurs. A list of these commitments is as follows:

- Maintenance of Common Equity
  (Centra 4.1, Union 7.1, Mergeco 6.1)

- Monitoring
  (Centra 10.1-10.3, Union 17.1-17.3, Mergeco 14.1-14.3)

- Status of Undertakings
  (Centra 7, Union 14.1, Mergeco 16.1)

- Management Costs
  (Centra 5.3, Union 13.1, Mergeco 10.1)

5.0.9 What follows is a discussion on the remaining commitments proposed by the Companies and the Board's comments on those commitments.

Preamble

5.0.10 For purposes of clarity, in the last paragraph of the preamble the words "approving these 1998 Undertakings" should be replaced with the words "approving the amalgamation and the conveyance of the common shares of Union Gas to Centra Gas Inc". **The Board recommends that the paragraph read:**

> *"NOW THEREFORE, in consideration of the Lieutenant Governor in Council approving* ***the amalgamation and the conveyance of the common shares of Union Gas to Centra Gas Inc.****, Westcoast, Westcoast Holdings Inc., Westcoast Gas Inc., Centra Holding Inc., Centra Gas Inc. and Mergeco agree to be bound by the following Undertakings."*

Definitions
(Centra 1.1-1.6, Union 1.1-1.8, Mergeco 1.1-1.8)

5.0.11 The proposed Undertakings use the Definitions contained in Union's current Undertakings, as these were more extensive, and contained essentially the same wording as those contained in Centra's Undertakings where terms were common. The Board concurs with the proposed Definitions.

Independent Directors
(Centra 2.1, Union 2.1, Mergeco 2.1)

5.0.12 The Companies chose Union's current requirement of one-third independent directors, as opposed to the Centra requirement for two independent directors. These independent directors must be residents of the merged company's franchise area. The merged company will continue Union's Undertakings with respect to a special Committee of Independent Directors.

5.0.13 The Board concurs with the proposed undertaking. Currently there are 6 directors in Centra and 9 in Union. The Companies had not yet determined the total number of directors for the merged company. Based on the Companies' evidence, the Board anticipates that the two geographical areas will be represented in the make-up of the

merged company's Board of Directors. While the Board views geographic representation from the two current franchise areas as desirable, it does not recommend that it be an undertaking.

Board Representation by Centra Directors and Officers
(Centra n/a, Union 2.7, Mergeco n/a)

5.0.14 Under the current Union Undertakings, the number of common Board Directors between Centra and Union is restricted. The Companies noted that, in a merged entity, this restriction is no longer applicable.

5.0.15 The Board concurs.

Separate Auditors from Westcoast
(Centra n/a, Union 2.8, Mergeco n/a)

5.0.16 Under the current Union Undertakings, the auditors of Union cannot be the same as those of Westcoast. Centra's current Undertakings do not contain this commitment. The Companies proposed to remove this restriction in order to pursue further cost reductions.

5.0.17 The Board notes that the savings of $75,000 were estimated on the basis of having the same auditor for all three companies. Under cross-examination it was revealed that the foregone savings from having separate auditors for the merged company and Westcoast are expected to be less than half the $75,000 amount. The Board considers such an amount to be modest in view of the value an independent assessment will provide to the regulatory process. The Board also notes that this condition is present in Consumers Gas' current Undertakings.

5.0.18 **The Board recommends that Union's current commitment regarding the need for separate auditors between Westcoast and the utility be continued in the merged company.**

Head Office Location
(Centra 2.2, Union 3.1, Mergeco 3.1)

5.0.19 The Companies chose the Union commitment to retain the head office in Chatham as opposed to the Centra commitment to retain its head office in Ontario.

5.0.20 Although the Companies' plans do not call for a move of the head office or a reduction in the operating size of the Chatham office, they were unwilling to commit to an undertaking, requested by the City of Chatham, that the current head office functions remain in Chatham on the grounds that such an undertaking would unnecessarily restrict future action of the merged company. The Board is sympathetic to the Companies' position. Moreover, the Board is of the view that such restriction may not allow for further cost savings in the future.

5.0.21 The Board recommended undertaking mirrors the Companies' proposal. However, the Board notes from the evidence that the legal meaning of head office is limited to the official address of a corporation and the location for maintaining corporate documents. This may or may not have been the intention of the LGIC when it initially approved the head office restriction.

5.0.22 **If the Undertaking relating to the location of head office was intended by the LGIC to go beyond the legal meaning, the Board recommends that the wording of this Undertaking be re-examined.**

Employment Levels
(Centra n/a, Union 4.1, Mergeco n/a)

5.0.23 The current Union Undertakings preclude a reduction in employment levels in Union as a direct result of Westcoast's acquisition of Union. Centra's current Undertakings do not contain this commitment. The Companies proposed to remove this restriction on the basis that the purchase was concluded four years ago.

5.0.24 The Board concurs. A number of important changes have taken place in Union's structure since 1992, including the shared services initiative, which make this restriction no longer relevant.

Change in Control
(Centra 2.3, Union 5.1-5.3, Mergeco 4.1-4.3)

5.0.25 The Companies effectively chose the Union commitment as it covers the circumstance of any non-arm's length transaction involving the acquisition of shares of the merged company as long as Westcoast maintains more than 50 percent of the votes for the election of the directors in the merged company.

5.0.26 The Board concurs.

Affiliate Transactions
(Centra 3, Union 6.1-6.2, Mergeco 5.1-5.2)

5.0.27 The Companies chose the Union commitment due to the inclusion of storage, and the requirement to demonstrate that the transaction is not detrimental to any utility customers.

5.0.28 The Board concurs but with the following changes which were the subject of discussion at the hearing.

5.0.29 The Board recommends that the words "or if" appearing in the first instance in Article 5.1 be replaced with the words "and if". The evidence was that this change, agreed to by the Companies in the hearing, would correspond with the Companies' practice in seeking approval for affiliate transactions. **The Board recommends that Article 5.1 read:**

> *"Other than the sale, transportation and storage of gas by Mergeco in the ordinary course of business, any Affiliate Transaction aggregating $100,000 or more annually shall require prior approval of the Ontario Energy Board, which approval shall not be withheld if the transaction is*

*shown to be of benefit to Mergeco and not to the detriment of any of its customers **and if** a purchase takes place at or below fair market value or if a sale takes place at or above fair market value."*

5.0.30 The word "or" appearing in the first line of Article 5.2 should be replaced with the word "and" to ensure that if either affiliate is aware that a transaction would be an affiliate transaction within the meaning of Article 5.1 of the Undertakings, a violation is deemed to occur. **The Board recommends that Article 5.2 read:**

*"It shall not constitute a violation of this undertaking if Mergeco **and** the Associate or Affiliate did not know or could not have been reasonably expected to know that a transaction was an Affiliate Transaction."*

Services Provided Between Centra and Union
(Centra n/a, Union 6.3, Mergeco n/a)

5.0.31 Under the current Union Undertakings, Centra and Union are to be managed and operated as separate companies. The Companies noted that in a merger scenario this requirement is no longer applicable.

5.0.32 The Board concurs.

Transactions with Union Shield Resources
(Centra n/a, Union 10.1-10.2, Mergeco n/a)

5.0.33 The Companies proposed to remove this restriction as Union no longer holds shares of Union Shield Resources.

5.0.34 The Board concurs.

Intercorporate Indebtedness
(Centra 4.2, Union, 11.1, Mergeco 9.1)

5.0.35 The wording of the current commitment is similar for both utilities. The Companies chose the Union wording. The exceptions relevant to Centra's Consolidated Deed of Trust, and Union's transactions with Union Shield Resources have been eliminated as they are no longer applicable.

5.0.36 The Board concurs.

Westcoast Preference Shares
(Centra n/a, Union 11.2, Mergeco n/a)

5.0.37 The Companies proposed to remove this restriction as the Westcoast preference shares will be redeemed in October 1997.

5.0.38 The Board concurs subject to the redemption of the shares occurring as planned.

Acquisition Costs
(Centra 5.1, Union 19.1-19.2, Mergeco n/a)

5.0.39 The current Undertakings require that Westcoast's acquisition costs for each of Centra and Union be borne by Westcoast. The Companies proposed to eliminate this requirement on the basis that it is not necessary, given that considerable time has passed since the acquisition of Union and Centra by Westcoast.

5.0.40 The Board concurs.

Assignment of the Boise Cascade Agreement
(Centra 5.2, Union n/a, Mergeco n/a)

5.0.41 Under the current Centra Undertakings, certain conditions were provided in the event that Centra received monies from Boise Cascade Corporation. As the Boise Cascade

Project is no longer part of Centra, the Companies proposed to eliminate this condition on the basis that it is no longer applicable.

5.0.42 The Board concurs.

Diversification and Reorganization
(Centra 5.4, Union 12.1, Mergeco 11.1)

5.0.43 The Companies chose the Centra commitment, modified to eliminate commitments respecting the Cogeneration Project which Centra no longer owns.

5.0.44 The Board notes that both utilities committed not to engage or invest in activities which are not regulated by the Board without Board approval. The additional provisions in Centra's Undertakings predate the most recent consideration by the Government of utility activities as embodied in the Union Undertakings. The Board is of the view that similar additional provisions are inappropriate for the merged company in light of current considerations of market restructuring and utility diversification.

5.0.45 **The Board recommends that the existing Union commitment regarding diversification and reorganization be continued in the Undertakings of the merged company.**

5.0.46 In the event that the LGIC chooses to accept the Companies' proposal, the Board **recommends** that, at the third line of Article 11.1(b), the words "storage and transportation" be inserted following the word "distribution" so that Article 11.1 (b) would read:

> *"The signatories shall make reasonable efforts to accomplish a restructuring of Mergeco such that there will result a corporation whose assets, liabilities and activities relate only to the regulated natural gas distribution,* ***storage and transportation*** *business in Ontario; and"*

Centra Gas Holdings Inc. Note
(Centra 5.5, Union n/a, Mergeco n/a)

5.0.47 The Companies proposed to eliminate this condition as the Centra Gas Holdings Inc. Note has been paid.

5.0.48 The Board concurs.

Dispensation With Compliance
(Centra n/a, Union 15.1, Mergeco 12.1)

5.0.49 The Centra Undertakings do not contain a clause regarding Board dispensation from compliance with the Undertakings. The Companies proposed to continue the Union commitment in the merged company.

5.0.50 The Board concurs.

Public Hearings
(Centra 6, Union 16.1, Mergeco 13.1)

5.0.51 The wording of the current commitment is similar for both companies. The Companies proposed to adopt the Centra wording.

5.0.52 The Board concurs.

Enforcement
(Centra 8, Union 20.1, Mergeco 17.1)

5.0.53 The Companies chose the Union commitment on the basis that it is more extensive.

5.0.54 The Board concurs.

Effective Date
(Centra 9, Union 21.10, Mergeco n/a)

5.0.55 The Companies proposed to remove the reference to effective date on the basis that the Order in Council is the legislative authority which gives force to the Undertakings.

5.0.56 The Board concurs.

York Region Project
(Centra n/a, Union 21.1-21.11, Mergeco 18.1-18.10)

5.0.57 Centra's current Undertakings do not contain this exemption. The Companies proposed to continue the exemption contained in the Union Undertakings.

5.0.58 The Companies resisted the suggestion by some parties that this exemption to the Undertakings be removed on the basis that it is no longer applicable. The Companies argued that, while Union was not the successful bidder in the York Region Project, the project is not a *fait accompli* and they would like to keep their options open should circumstances change. The Companies also argued that the approach to developing the Undertakings for the merged company should be limited to combining the existing Undertakings into a common set of Undertakings.

5.0.59 The Board notes that the exemption granted to Union with respect to the York Region Project makes specific reference to the Request for Proposal dated September 19, 1995. Union was not the successful bidder. The Board is of the view that any further activity relating to the York Region Project should require a further exemption from the Undertakings.

5.0.60 In drawing this conclusion the Board considered the Companies' proposal for limited review in developing the new Undertakings. The Board notes that certain other changes have been proposed by the Companies which are unrelated to the merger but, nevertheless, make good administrative sense in that the circumstances no longer apply.

5.0.61 **The Board recommends that the exemption relating to the York Region Project not be included in the Undertakings of the merged company.**

Halton Region Project
(Centra 11.1-11.2, Union 22.1-22.12, Mergeco 19.1-19.12)

5.0.62 The Companies noted that the proposed exemption contains the same wording as in the current Undertakings for both companies.

5.0.63 The Board concurs. According to the evidence, a Request for Proposal had not been issued by the Regional Municipality of Halton at the time of the hearing. Therefore, the current exemption continues to be valid.

Comprehensive Review of Undertakings

5.0.64 The Board has approached its review of the Undertakings on the basis of changes that are required due to the merger. The Board also recommended certain eliminations of Undertakings which clearly no longer apply.

5.0.65 However, the Board notes that, once the result of the current reviews of market restructure and utility diversification are known, **it may be necessary to conduct a comprehensive review and assessment of the Undertakings of the merged company. At that time, it may be appropriate to address the need for more uniformity in the Undertakings of the merged company and Consumers Gas.**

6. DEFERRAL ACCOUNT

6.0.1 In a letter to the Board dated January 8, 1997, the Companies requested that the Board issue an accounting order to record in a deferral account the one time O&M costs to effect the merger. These costs, amounting to $2.0 million, were presented at the merger hearing. The Companies requested that the accounting order request be reviewed as part of the merger hearing.

6.0.2 The Companies proposed to amortize the costs in proportion to the forecast savings so that no negative rate impact would result from the incurrence of upfront operating costs. This treatment would be consistent with the treatment approved by the Board in the shared services initiative.

6.0.3 Certain parties questioned the appropriateness of certain costs on different grounds. It was suggested that certain costs represented double-counting, or that they should have been forecast for the rates case. It was also suggested that Westcoast stands to benefit from the merger and should consequently bear the costs.

6.0.4 The Board observes that $236,000 of the proposed one time O&M costs were incurred in 1996. This amount consists of $57,000 in Legal and Treasury, $167,000 in Regulatory and $12,000 in Communications. The Board considers the Companies' request to include these costs contrary to sound regulatory practice. In the normal course, the Companies would not include in their forecast test year cost of service, any costs that were incurred in an historical year. These are clearly out of period costs; they should be borne by the utilities' shareholder, not by the ratepayer. The