

RP-2000-0078

IN THE MATTER OF the *Ontario Energy Board Act, 1998*,
R.S.O. 1998, c. 15, Sched. B;

AND IN THE MATTER OF an Application by Union Gas
Limited for an order or orders approving the unbundling of certain
rates charged by Union Gas Limited for the sale, distribution,
transmission and storage of gas.

BEFORE: Malcolm Jackson
Presiding Member

George Dominy
Member

Paul Sommerville
Member

DECISION WITH REASONS

July 31, 2002

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Appendix A - ISSUES LIST as approved by the Board June 6, 2001

Appendix B - SETTLEMENT PROPOSAL as agreed to by parties January 28, 2002

1. THE APPLICATION AND THE PROCEEDING

1.1 THE APPLICATION

1.1 Union Gas Limited ("Union") filed an application, dated July 31, 2000 (the "Application") with the Ontario Energy Board (the "Board") for an order or orders approving the recovery through rates of the costs of further unbundling Union's rates to provide access to unbundled services by small volume customers, and for appropriate accounting or interim orders. The Board has assigned this Application Board File No. RP-2000-0078.

1.2 In its pre-filed evidence Union indicated that, for those small volume customers that contract to purchase the commodity gas from a supplier other than Union, Union proposes to continue to offer utility-consolidated billing whereby Union bills the customer for its own utility services and also bills for the commodity on behalf of the third party supplier. In addition, Union proposes to offer a split billing option whereby it would bill the customer for only its utility services and would provide information to the third party supplier so that it could bill the customer for the commodity and any other services supplied by the third party. Union will also provide the third party supplier with information which it will require to manage its day to day supply arrangements, upstream and on the Union system.

1.2 THE PROCEEDING

- 1.3* Union's pre-filed evidence in the case was filed October 23, 2000. The Board issued a Notice of Application dated February 22, 2001.
- 1.4* Procedural Order No. 1 was issued on May 17, 2001, setting dates for an Issues Conference and an Issues Day.
- 1.5* By Procedural Order No. 2, dated June 6, 2001, the Board approved an Issues List (Appendix A to this Decision with Reasons).
- 1.6* Procedural Order No. 3 was issued July 13, 2001. It set dates for interrogatories, filing of intervenor evidence, and an interrogatory process for intervenor evidence.
- 1.7* Procedural Order No. 4 was issued November 1, 2001, setting dates for filing supplemental material, interrogatories and responses to interrogatories.
- 1.8* By letter dated November 16, 2001, the Board invited intervenors to comment on the process for proceeding with the Application and, in particular, on whether segregating the issues and phasing the hearing would be appropriate. By letter dated November 26, 2001, Union responded to intervenor comments. The Board's Procedural Order No. 5, issued December 8, 2001, stated that the Board would test the evidence of this Application in its entirety, but that the Board might defer a decision with respect to billing until after the Board finalized the Gas Distribution Access Rule.
- 1.9* Procedural Order No. 5 also set dates for parties to provide position papers for a Settlement Conference as part of an alternative dispute resolution ("ADR") process, and for filing any proposed settlement of the issues with the Board.
- 1.10* Procedural Order No. 6 was issued January 7, 2002, establishing revised dates for the Settlement Conference.

- 1.11* The Board received a Motion, dated January 22, 2002, from counsel for The Convergence Group ("TCG") requesting that the Board issue an order granting TCG late intervenor status. Union and the Intervenors accepted the participation of TCG in the Settlement Conference.
- 1.12* Union filed a settlement proposal as agreed to by parties (the "Settlement Proposal" or "Settlement Agreement") on January 29, 2002. The parties proposed that Issue 3.3, concerning the treatment of the Incremental Unbundling Costs Deferral Account ("IUCDA"), be argued before the Board.
- 1.13* Procedural Order No. 7 was issued January 30, 2002. It set February 1, 2002, as the date for hearing TCG's Motion concerning its late intervention and for the Board to address the Settlement Proposal.
- 1.14* The Board granted TCG's Motion orally on February 1, 2002, and heard parties' proposals concerning the method of proceeding with hearing the unsettled issues, particularly concerning Issue 3.3.
- 1.15* Procedural Order No. 8 was issued February 7, 2002. The Board decided to combine this proceeding with Union's Customer Review Process proceeding RP-2001-0029 with respect to the issue of the IUCDA, to the extent necessary and only to the extent necessary, to hear all aspects of that issue. Procedural Order No. 8 also rescheduled the commencement of the hearing of evidence to February 20, 2002.
- 1.16* The oral hearing commenced on February 20, 2002 and was concluded on February 28, 2002 after seven hearing days. Union's Argument-In-Chief was presented orally on March 13, 2002. Twelve intervenors filed argument by April 3, 2002. Union filed its Reply Argument on April 24, 2002.

1.3 PARTICIPANTS AND THEIR REPRESENTATIVES

1.17 Below is a list of participants and their representatives that participated actively, through the settlement conference process, through leading evidence or cross-examining at the oral hearing, or by filing argument.

Union Gas Limited	Patricia Jackson Marcel Reghelini
Board Counsel	Pat Moran
Coalition for Efficient Energy Distribution ("CEED")	George Vegh
The Convergence Group ("TCG")	George Vegh
Enbridge Gas Distribution Inc., formerly The Consumers' Gas Company Ltd. ("EGDI")	Jerry Farrell Barbara Bodnar Robert Rowe
City of Kitchener ("Kitchener")	Alick Ryder
Vulnerable Energy Consumers' Coalition ("VECC")	Michael Janigan
Wholesale Gas Purchasers Service Group ("WGPSG")	Andrew Taylor
TransCanada PipeLines Limited ("TCPL")	Tibor Haynal
The Heating, Ventilation, Air Conditioning Contractors Coalition Inc. ("HVAC Coalition")	Ian Mondrow
Consumers' Association of Canada ("CAC")	Robert Warren
Industrial Gas Users Association ("IGUA")	Peter Thompson Michelle Flaherty
Direct Energy Marketing Limited ("Direct Energy")	David Brown
Ontario Energy Savings Corporation ("OESC")	Tom Woodward
Cities of Greater Sudbury and Timmins ("Cities")	Peter Scully
London Property Management Association ("LPMA")	Randy Aiken
Hydro One Networks Inc. ("HONI")	Glen MacDonald

1.18 Others that commented on or observed these proceedings were:

Entuit Solutions	Frank Fernandez
Sempra Energy Trading	Louis Draginov
Electricity Distribution Association	Tony Paul

1.4 WITNESSES

1.19 The following Union employees appeared as witnesses:

Michael Packer	Manager, Rates and Pricing
Wayne Andrews	Manager, Customer Support
Richard Birmingham	Vice-President, Finance and Business Services
Anne Creighton	Director, Public Affairs and Communications
Robert Feldmann	Director, Retail Services

1.20 In addition, Union called the following witnesses:

Richard Schwindt	Associate Professor of Economics Simon Fraser University
Brian Deas	Vice-President, Client Services Canadian Facts
Brook Tyler	Research Director Canadian Facts

1.21 TCG called the following witnesses:

Douglas Davey	Executive Vice President Northstar Research Partners
Peter Zoutis	Research Associate Northstar Research Partners
Gerry Haggarty	Director, Natural Gas Toronto Hydro Energy Services
Arnel Schiratti	Director of Energy Supply and Regulatory Affairs Sunoco Inc./Suncor Inc.

1.22 Direct Energy called the following witness:

Michael Trebilcock	Professor of Law University of Toronto
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1.23 VECC called the following witness:

John Todd	President Econalysis Consulting Services Inc.
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1.5 SUBMISSIONS AND EXHIBITS

1.24 Copies of the evidence, exhibits, arguments, and a transcript of the proceeding are available for review at the Board's offices.

1.25 The Board has considered all 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 background or support for its findings.

1.26 A copy of the Board-approved Issues List and a copy of the Settlement Proposal are provided in Appendix A and Appendix B, respectively.

1.27 The Board, with industry participation, has developed standards and processes for 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 of the Decision with Reasons are issued in hard copy. The ERF version will have the same text and numbered headings as the version originally issued, but may be formatted differently.

2. BACKGROUND AND CONTEXT OF THE APPLICATION

2.1 Background on three previous regulatory initiatives provides context for this Application and Decision. They are:

- the Market Design Task Force;
- the Gas Distribution Access Rule; and
- the RP-1999-0017 Union rates proceeding.

These initiatives are briefly described.

2.1 THE MARKET DESIGN TASK FORCE

2.2 The Market Design Task Force ("MDTF") was established at the Board's suggestion and met first in 1998. Its members included the gas utilities operating in Ontario, marketers, an upstream transportation provider, consumer groups and Board staff. Union was a participating member. The MDTF's mandate was to report to the Board on ways and means to enhance competition in natural gas consistent with a consensus-based policy framework. The MDTF addressed unbundling during its 1998-99 sessions.

2.3 The MDTF, in its Final Report issued in February 1999, defined unbundling as:

- the separate pricing and offering of the discrete elements of LDC services; and
- the further opening of previously monopolized elements of sales service to alternative suppliers of those services.

2.4 The Rates and Services Subcommittee of the MDTF recommended that the unbundling of transportation and the unbundling of storage be given priority. The MDTF's final report set out major milestones for the unbundling process and identified the unbundling of upstream transportation, storage, load balancing and billing as priorities. The final report of the MDTF made the following recommendations:

- that a wholesale rate for unbundled transportation services and unbundled storage services be developed for marketers, including the terms and conditions governing nomination and delivery of daily requirements and imbalance settlements;
- that an expanded menu of unbundled services, including billing and collection, be made available to marketers; and,
- that an expanded menu of unbundled services, including storage, billing and collection, be made available to general service customers on an optional basis.

2.5 The MDTF stated that unbundling "should occur as expeditiously as possible, but in an orderly and manageable fashion so as not to compromise the LDC's critical systems and operations".

2.2 THE GAS DISTRIBUTION ACCESS RULE

2.6 On December 6, 1999, Board staff issued an invitation to interested parties to participate on a task force that would assist in developing a Gas Utility Access Rule, later renamed the Gas Distribution Access Rule ("GDAR"). Union participated on the GDAR Task Force and in all other aspects of the development of the GDAR.

2.7 Among the issues addressed by the Task Force was the question of billing options. The following options were considered:

- distributor-consolidated billing: the distributor issues periodic bills to gas consumers and, if the consumer is supplied by a marketer, the distributor remits to the marketer the funds due to it. This has been the typical billing practice for small volume natural gas consumers in Ontario;

- split billing: the distributor issues bills to consumers to which it provides services and bills only for the services it provides; the marketer issues bills to the consumers to which it provides services and only for the commodity and services it provides. This option is also known as direct billing, and is a service which Union currently makes available to its largest customers; and,
- marketer-consolidated billing: the marketer issues periodic bills to the consumer for the commodity and all services and remits to the distributor the funds due to it for services which the distributor provides. This option is not currently available to gas users.

2.8 The GDAR Task Force reported to Board staff in June 2000 and made 31 recommendations, 30 of which were decided by a clear majority. The Task Force did not reach a consensus on what billing options should be mandated. At the time when this application was filed, Board staff were preparing a draft rule. That staff draft rule required that gas distributors be able to provide three billing options and that natural gas customers be able to choose to be billed under one of them.

2.9 The Board, after consideration of stakeholder comments on the staff draft, issued on February 6, 2001, for written comment, the Proposed Gas Distribution Access Rule (the "Proposed GDAR"). The Board also provided an opportunity for oral presentations of comments. The Board's Proposed GDAR required three billing options and allowed the customer to choose the billing option desired.

2.10 At the time of this hearing, the Board's report on the results of its consultation on the Proposed GDAR was under preparation. The Board's report, which was issued June 19, 2002, requires that gas distributors be able to accommodate three billing options. Further consultations are under way.

2.3 THE RP-1999-0017 UNION GAS RATES PROCEEDING

2.11 Union's RP-1999-0017 application requested an order or orders of the Board approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas in accordance with a performance based mechanism for changing rates annually during a multi-year term commencing

January 1, 2000. Union also sought the Board's approval of the design and provision of unbundled storage services and unbundled upstream transportation services. Union proposed to pursue the unbundling of customer billing and the development of a wholesale delivery rate through a separate application.

- 2.12 The parties to the RP-1999-0017 proceeding negotiated a Settlement Agreement, dated June 7, 2000, settling most of the unbundling issues, but were not able to reach agreement on the terms and the allocation of the upstream transportation. Union noted that implementation of its proposal could require new and enhanced systems to manage daily nominations and other parameters associated with unbundled services. Parties to the RP-1999-0017 Settlement Agreement acknowledged this, stating:

"The parties acknowledge the necessity to address rates and services related to retail billing through a subsequent application in order to provide small volume, non-daily metered customers access to the new unbundled services. Union commits to filing this application by July, 2000 and agrees to forgo the consultation process originally contemplated in order to dispose of the application as soon as practicable to allow for the unbundled services for the small volume market to be accessed as close to April 1, 2001 as possible.

The parties also acknowledge that Union will incur certain costs in order to be in a position to provide the new unbundled services. The costs and the associated recovery will be addressed under Issue 4.2 - Incremental Unbundling Costs Account, during the hearing."

(Reference: RP-1999-0017, Settlement Agreement, p. 37)

- 2.13 The Board accepted the RP-1999-0017 Settlement Agreement, and addressed the unsettled issues in its RP-1999-0017 Decision.

- 2.14 This Application addresses the implementation and effects of offering the unbundled services for the small volume market.

3. BILLING PRACTICES AND OPTIONS

3.1 REVIEW OF THE EVIDENCE

3.1 Union currently provides distributor-consolidated billing to its system gas customers and to the small volume competitively supplied customers through the Agency, Billing and Collection ("ABC") Service which was introduced in 1997.

3.2 Union proposes to make changes to its business systems which would make it possible for Union to offer unbundled storage services and also permit Union to offer a split billing option to small volume customers.

3.3 The Board heard much evidence on billing practices and options in this proceeding, including:

- the merits of split billing versus marketer-consolidated billing;
- Union's intention to improve ABC billing;
- implementation issues associated with marketer-consolidated billing;
- lack of a definitive marketer-consolidated billing model to evaluate and absence of cost data; and,
- appropriateness of expanding split billing to all customer classes.

3.4 Union's witness identified several issues potentially arising from the implementation of marketer-consolidated billing, including:

- the distributor's recourse for payment, especially in situations where the customer has paid the marketer on the understanding that the marketer would remit funds to the distributor but the marketer does not do so;
- disconnection for non-payment;
- bill true up and finalization practices, including potential disconnection and re-connection of service, when customers relocate;
- continued provision of specialized billing services presently offered by Union, for example group billing;

- billing for other services (e.g., meter relocation, contributions in aid of construction, Natural Gas for Vehicles cylinder rentals);
- ongoing customer communications; and,
- the adaptability of Union's customer account number driven billing system architecture.

3.5 These issues may require Union to allocate resources to achieve resolution. Some of these matters may be dealt with outside of the Board's formal processes, for example through negotiation of service agreements as discussed in the Proposed GDAR of June 19, 2002.

3.6 While the process to finalize the GDAR is advanced, it is not complete as of this writing. The Board's Proposed GDAR, dated June 19, 2002, specifies the billing options which gas distributors are expected to be able to accommodate and provides for a process for exemption from some or all of the provisions of the GDAR. The GDAR is expected to address certain risks to which distributors may be exposed, such as liability for non-payment, recourse in situations of non-payment.

3.2 BOARD FINDINGS

3.7 The Board considers it inappropriate at this time to decide an issue raised in this specific Application when Board policy on that issue is being developed broadly through another process.

3.8 The Board, therefore, considers it premature to make a final decision on billing and related issues raised in this proceeding. The Board is aware that billing practices and options may affect competition in the commodity market and may affect prices. It is also possible that some billing practices and options will have no measurable effect on competition whether they are offered or not.

3.9 In the Board's view, although it would be premature to decide on whether or not some form of marketer-consolidated billing should be offered, the Board sees merit in Union's proposal to offer split billing in addition to its distributor-consolidated

billing option. The Board expects that when the GDAR comes into effect, Union will comply or make the applications it considers appropriate.

3.10 Reference to the record of this proceeding as well as the comments of parties acquired through formal public Board sponsored processes may assist the Board in future deliberations on billing and related issues.

4. DESCRIPTION OF PROPOSED SYSTEMS AND SERVICES

4.1 CURRENT SYSTEMS

4.1 Union stated that it developed and made available unbundled services to conform to a recommendation of the Market Design Task Force and to comply with the RP-1999-0017 Settlement Agreement. Unbundled storage services have been available to large volume customers since November 2001. To date, however, none has utilized this service. Union testified that it continues to receive strong and ongoing expressions of interest for unbundled storage services from customers, including the largest marketer operating in Union's franchise territory.

4.2 Union's witnesses testified that the system changes to enable unbundling have not been made to accommodate marketers but rather to facilitate transactions necessary to support provision of unbundled services.

4.3 Union portrayed its current business systems for contract administration as lacking the ability to achieve acceptable levels of service and to effectively administer unbundled services. Union's existing contract system is constrained to allowing a unique price for each individual contract, whether that contract relates to one or several consumers. To effect a change in price, existing contracts must be terminated and new contracts entered into, a time consuming process. Also, Union's current business systems for small volume customers are constrained to permit only distributor-consolidated billing.

4.4 Union's current operations provide balancing of both supply and demand on its distribution system. For most customers, Union receives daily a fixed fraction of the contractually established annual contract quantity, typically 1/365th. Direct purchasers have an obligation to deliver this quantity daily. Union assumes the responsibility for balancing this against its customer's fluctuating daily consumption.

4.5 Union's existing business systems for contract administration, nominations and distribution system balancing are manually administered through fax and paper driven processes. System gas customers and small volume direct sales customers are currently balanced as an aggregated group. As such, the existing system can respond to and process the current low volume of transactions submitted presently, although not always in the time frame desired.

4.2 UNION'S PROPOSED SYSTEM CHANGES

4.6 Union is redesigning its business systems to overcome existing constraints and to allow unbundled services to be provided to the small volume market. Union stated that it has achieved this in a way which neither gives rise to stranded utility assets at Union nor requires that Union increase its staffing.

4.7 The business system changes to effect the provision of unbundled services to the small volume market emphasize customer specific daily system management and were generally described in the RP-1999-0017 Settlement Agreement. Under the proposed unbundled storage services, the responsibility for managing storage assets would shift from Union to those individual marketers which utilize the unbundled services; these marketers would assume the risks of balancing deliveries against consumption and would manage these risks through the tools provided by the unbundled services.

4.8 The proposed system changes include a daily balancing mechanism that permits tracking a customer's balances. This daily balancing is supported by:

- enhanced contract administration and billing systems;
- systems to allocate and track storage inventory balances;
- enhanced systems to track daily supply and demand imbalances;

- systems to estimate demand of heat sensitive loads; and,
- electronic interfaces with customers.

4.9 Union has designed an internet based communications protocol which permits "self-service" for marketers and individual consumers. According to Union's evidence this will replace the existing manual interface.

4.10 Union testified that once the proposed changes have been implemented existing staff will be able to handle significantly more transactions than it does currently.

4.11 It is Union's evidence that, while these system changes do not lend themselves to other applications, they can be "extended" or "leveraged" to accommodate transactions required by the Proposed GDAR, such as service transaction request processing. Union's witnesses testified that these system changes are able to be part of the necessary foundation to support Union being able to accommodate marketer-consolidated billing. Union also testified that the proposed changes would not increase the costs of other system changes which may be required to provide other such services. Union also testified, however, that the proposed system changes cannot, without further expenditure, provide other services.

4.3 PROPOSED SERVICES AND RATES

4.12 Historically, Union has provided storage services to its in-franchise customers at prices determined by the Board through a cost of service methodology.

4.13 Union currently offers a bundled transportation rate in its Northern and Eastern Operations Area. The proposed unbundling would result in a residual bundled transportation rate that excludes charges for storage, inventory carrying and delivery/redelivery services. Union's Northern and Eastern customers can elect standard storage service coupled with delivery/redelivery service.

4.14 In the Southern Operations Area, Union currently offers a bundled delivery rate. The proposed unbundling would result in a residual bundled delivery rate that excludes charges for standard storage service, standard peaking service, inventory carrying and

load balancing. Standard storage service would be available if certain conditions are met.

4.15 In both Operations Areas, Union has proposed a separate rate schedule, U2 or S1, for unbundled service, and has provided a volume-based rate for the proposed unbundled storage service. The proposed rates have been designed such that when the rates for the unbundled services are aggregated they are equivalent to the rate charged for the previously bundled service.

4.16 The Settlement Proposal in this case indicated that parties did not take issue with respect to the impact of the proposed rate changes on either system gas or non-system gas customers. However, three parties to the ADR, Direct Energy, CEED, and the City of Kitchener, did not in the Settlement Proposal agree to the proposed unbundled rates, and stated that they sought a commitment that Union would address the need for a separate load balancing and flexibility rate and would do so for the 2003 customer review process.

4.17 Union stated that the proposed changes to the rate schedule are intended to:

- allow small volume customers to compare service options;
- facilitate access to unbundled services;
- achieve greater price transparency and understanding of customer choice; and,
- allow Union to realize a higher level of gas distribution system utilization.

4.18 Union's witnesses suggested the following examples of how a marketer could benefit from unbundled storage services:

- the marketer could control the costs differently from Union;
- the marketer could realize an economic gain, relative to Union; and,
- the marketer could take advantage of cheap commodity gas when available, because it may be able to store the gas and arbitrage its sale in a future period.

4.19 During the hearing no party questioned the appropriateness of the proposed unbundling of the former bundled rates or of the proposed rates schedules. Union's

witnesses explained that marketers were involved in the development of the unbundled services and that Union periodically requested input from marketers.

5. QUANTUM, PRUDENCE AND ALLOCATION OF RESPONSIBILITY FOR RECOVERY OF THE DEFERRED SYSTEMS AND COMMUNICATION COSTS

5.1 REVIEW OF THE EVIDENCE AND ARGUMENT IN CHIEF

The Incremental Unbundling Costs Deferral Account

5.1 By letter dated September 21, 1999, Union requested an accounting order of the Board establishing the IUCDA. This account was proposed to accrue the costs of system changes, process changes, and the new systems required to implement the unbundling of upstream transportation and storage, and for customer billing. During RP-1999-0017 Union estimated that \$5 million of costs would be recorded in this account. This estimate was later increased to \$7.5 million. The preliminary fiscal 1999 closing balance was \$1.4million which was later reduced to \$1.0 million. It is currently estimated that the IUCDA will accrue a debit balance of \$15.7 million in total. To date, approximately 75% of the forecast costs have been incurred.

5.2 Union stated that the proposed system changes to provide unbundled storage services arose in two phases:

- phase 1, dealt with during the RP-1999-0017 proceeding, in which Union tested concepts and ideas, and designed processes that would result in making unbundled services available to small volume customers. Union forecasted the costs of this phase to be \$7.5 million; and,
- phase 2, dealt with in this proceeding, in which Union addressed the implementation of unbundled services to its small volume customers and the associated contract administration changes. Union indicated that the costs incurred in phase 2, forecasted to be \$8.2 million, were primarily driven by a need to address the complexity of daily nominations for individual

consumers through marketers, the daily balancing of supply and the increased number of individual transactions. Union designed an electronic customer interface so that Union and marketers could exchange information on upstream pipeline capacity, storage nominations and daily contract quantities in support of marketers effectively utilizing unbundled storage services. Lastly, during this phase Union implemented additional functionality of the new business systems and made a second billing option, the split billing option, available.

- 5.3 Union stated that the costs of the proposed system changes are one time in nature.
- 5.4 Union used internal resources and external contractors to effect the proposed system changes. Union contracted for services which it did not wish to develop in-house, such as internet communication services. Union did not use a competitive tendering process to select external contractors; rather it relied on contractors which had previously performed systems work for Union. Union testified that it monitored current market prices for such work to ensure that "going" rates were paid.
- 5.5 Union's witnesses testified that most of the unbundling costs arose from making the unbundled services available for the small-volume market. According to Union's witnesses, making unbundled storage services available to large volume customers exclusively would have cost approximately only \$400,000 - \$500,000. Union also testified that the costs of the proposed system change attributable to the provision of the split billing option are approximately \$800,000.
- 5.6 Union did not perform a cost-benefit study. Union did not conduct any focus group or other consumer research to understand the demand of small volume customers for unbundled storage services. Union relied upon the settlement of the unbundling issue achieved during the ADR of the RP-1999-0017 proceeding and on the recommendations of the Market Design Task Force as demonstrations of broad-based industry consensus supporting the unbundling of services. At several different times during the development of the redesigned business and operating systems, Union invited marketers to participate in informal demonstrations and trials of these new systems.

- 5.7 The Board heard testimony about unbundling in other Canadian jurisdictions. Mr. Todd testifying for VECC stated that Gaz Metropolitan Inc. ("GMi") initially proposed to provide unbundled services to all customers. He stated, however, that during the scoping phase of this initiative, GMi realized that the costs of making these services available universally were significant and that GMi subsequently revised its implementation plans and these services were not made available to the small volume market. Mr. Todd testified that BC Gas Inc. opted to conduct a market test of unbundled services using a manually operated system, and that, based on this test, BC Gas Inc. concluded that implementation across all customer classes was premature.
- 5.8 Dr. Schwindt and Mr. Todd both addressed the decision making surrounding the provision of unbundled services. It was their view that the provision of new services should be supported by industry consensus or by a cost-benefit analysis.

The Comprehensive Customer Information Program Deferral Account

- 5.9 The Comprehensive Customer Information Program Deferral Account ("CCIPDA") was established to accrue the costs of communicating changes in service to customers; in this instance, changes in storage services and billing options to small volume customers. This account is projected to accrue a debit balance of \$550,000 to fund the provision of bill inserts and the anticipated costs of outsourcing Union's call centre activities. Union proposed to co-ordinate its educational effort with ongoing customer communications, using messages tailored to each audience and co-ordinated with relevant initiatives of marketers.
- 5.10 Union testified that its communications programs are planned to achieve customer satisfaction relative to the message being communicated. Union plans to utilize bill inserts and notices printed on the bill. Union considers bill inserts its optimal communication mechanism, in respect of effectiveness and also cost efficiency. Union also proposed use of a direct mailing from the marketer and Union jointly to announce changes in billing before they are implemented with respect to a specific customer.

Proposed Disposition of IUCDA and CCIPDA

- 5.11 Union applied to dispose of the balances in the IUCDA and CCIPDA to the small-volume rate classes, M2, 01 and 10, by allocating them to each customer class on the basis of a weighted average number of customers in each class (time-weighted for a recent annual period) and then to recover the class cost on a basis to be determined in Union's Customer Review Process proceeding RP-2001-0029. Union provided an illustration of customer impact if the resulting class costs were then recovered on the basis of volume of gas delivered. In the illustration, Union would recover, on average:
- \$8.31 from each rate M2 customer;
 - \$11.28 from each rate 01 customer; and
 - \$39.30 from each rate 10 customer.
- 5.12 Union stated that it has used such an allocation previously to recover the incremental one-time costs of process and system changes to provide ABC billing to small volume customers.
- 5.13 A number of alternative dispositions of these costs were proposed by parties, including:
- amortization of the cost and its recovery over a period greater than one year;
 - recovery from parties other than small volume customers, including the possibility of recovery through a charge to marketers;
 - partitioning the total incremental unbundling cost and according each partition a unique disposition and recovery methodology; and
 - other allocation approaches based solely on volume or on transactions.
- 5.14 Union's testimony was that without certainty of cost recovery it would not have proceeded with unbundling. Union stated that it does not seek a recovery mechanism which may not fully recover the balances. Nor does it support recovery over several periods.

- 5.15 Union does not favour a volumetric allocation of costs to customer classes because Union asserts that it does not capture the fact that the proposed system changes are transaction driven. However, Union does not support recovery through a transaction fee. Union does not favour recovery from customers other than rate M2, 01 and 10 as the proposed system changes are required in order to allow services to be provided to these customers.
- 5.16 Union argued in chief that its unbundling initiative is supported by a broad based consensus demonstrated by the RP-1999-0017 Settlement Agreement and the consistency of the proposed services with the recommendations of the Market Design Task Force. Union reiterated that unbundling is desirable because it provides flexibility of supply options which are expected to lead to increased competition for the commodity. Union stated that during the settlement process in RP-1999-0017 Union disclosed that it would be necessary to incur further costs in order to be in a position to provide the new unbundled services.
- 5.17 Union argued that its existing systems were labour intensive, relative to the business system modified as proposed, and were not able to provide the transaction processing cycle time and other desirable aspects of quality of service or performance. Further, Union stated that the proposed business systems would automate these existing manual systems and allow for the provision of unbundled storage services to the small volume market.
- 5.18 Union stated that the system changes proposed to effect unbundling of storage to the small volume market are such that they provide the functionality to offer split billing. Union also stated that it proposes to continue to offer its ABC service concurrently with the introduction of split billing, and that the offering of split billing does not impact the systems or costs to provide ABC service.
- 5.19 Union argued that the costs to provide unbundled services were prudent. Union considered its use of contractors familiar with its business systems appropriate and reasonable, and noted that it monitored current rates for such services from external contractors to ensure that it paid going or market rates.

5.20 Union argued that it was appropriate to use the weighted number of customers as the allocation factor to dispose of the deferral account balances to small volume customer classes. This allocation factor, Union stated, reflects the fact that the proposed system changes will facilitate transactions and that the number of transactions is correlated with the number of customers.

5.2 POSITIONS OF THE INTERVENORS AND UNION'S REPLY

The Consumers' Association of Canada

5.21 CAC submitted that the Board should acknowledge deficiencies in the evidence supporting the proposed unbundled rates, such as:

- the lack of a cost-benefit analysis;
- the lack of small volume customer demand for the proposed unbundling; and
- the lack of disclosure of costs in previous proceedings.

5.22 CAC suggested that further unbundling initiatives should be supported by the Board's prior approval.

5.23 However, CAC argued that it would be unfair for the Board to reject this proposal in light of the Settlement Agreement and the Board's Decision in the RP-1999-0017 proceeding. CAC noted that none of Union's large volume customers have made use of the unbundled storage services which have been available to them for some time. CAC argued that the Board should accept Union's unbundling proposals.

5.24 CAC noted that there was no evidence that the costs of unbundling might exceed the \$7.5 million disclosed during the RP-1999-0017 proceeding. Nonetheless, CAC submitted that the Board should find that the costs incurred to provide the proposed unbundled services prudent.

5.25 CAC submitted that the bulk of the costs incurred to implement the unbundling proposal should be recovered from marketers. According to CAC, the evidence is clear that marketers will, ultimately, stand to benefit from Union's unbundling proposal. CAC proposed that the costs be deferred and collected through a per

customer charge to be paid by those marketers who chose unbundled service. However, if it is the Board's view that unbundling benefits all customer through lower commodity prices, then CAC argued the costs should be recovered from all in-franchise customers on a volumetric basis to recognize that the unbundling benefits received increase with the volume of gas consumed.

- 5.26 CAC submitted that the proposed communication costs relate to both unbundling and billing and that they should be allocated to general service customers in proportion to the weighted average number of customers.

The Coalition for Efficient Energy Distribution

- 5.27 CEED argued that Union should have acted on an outstanding directive of the Board which required Union to deal with flexibility costs and that these costs should not be included in the distribution rates charged to bundled or unbundled direct purchase customers. CEED pointed out that a flexibility cost calculated as the difference between actual landed costs and TCPL (FT) capacity is meaningless as Union's portfolio is devoid of TCPL capacity. CEED submitted that the load-balancing/flexibility service should be redesigned for the purposes of determining Union's 2003 rates.
- 5.28 CEED questioned whether all of Union's proposed system changes expand and facilitate consumer choices and argued that only the costs of those system changes that facilitate customer choice should be recovered from the customers.
- 5.29 CEED argued that there is no evidence that, by allowing Union to recover its billing costs from all customers through the unbundling deferral account, customer choice will be facilitated. According to CEED, the cost of billing for storage should be attributed to facilitating Union's cost of operating a competitive storage business. CEED submitted that if such costs were recovered from in-franchise customers cross-subsidization would occur between Union's storage and transportation customers and its in-franchise customers, and that Union's competitors in the storage business would be disadvantaged to the extent that Union is able to pass such billing costs along to the ratepayers.

5.30 Nonetheless, CEED supported Union's proposed allocation to in-franchise customers on the basis that the customers that benefit from unbundling are those that have the option to use the unbundled services and that recovering the unbundling costs exclusively from the unbundled customers would create the market distortion of making unbundled service artificially unattractive when compared to competitive alternatives.

The City of Kitchener

5.31 Kitchener was concerned that Union's unbundled storage services were not yet utilized by large volume customers and lacked confidence that efficiencies would be realized. Kitchener asserted that the new processes and systems may nonetheless result in efficiencies for direct purchase customers or Union.

5.32 Kitchener argued that the costs should therefore remain in a deferral account for the time being and that they should ultimately be recovered from those customers that benefit from the efficiencies. Kitchener further argued that the Board should allow Union more time to justify its unbundling expenses and require Union to report on the savings it has achieved as a result of these new systems and processes.

Enbridge Gas Distribution Inc.

5.33 EGDI submitted that without the benefit of hindsight, Union's unbundling costs appear to be reasonable and prudent and that they should be recovered as Union proposed.

Industrial Gas Users Association

5.34 IGUA submitted that providing unbundled services to all customer classes was supported by a broadly-based consensus and that unbundling storage services cannot be considered as an independent activity of the overall unbundling exercise.

- 5.35 With regard to the issue of the prudence of the unbundling costs IGUA submitted that it will rely on the Board to determine the prudence of the unbundling costs and disallow any costs which, in the Board's view, are unreasonable or excessive.
- 5.36 IGUA submitted that the prudently incurred unbundling costs should be recovered from the small volume customer rate classes because they were incurred to be able to provide unbundled services to this customer class. IGUA supported Union's proposed cost allocation factor and emphasized that none of the systems and process changes proposed by Union in this proceeding relate to large volume customers. IGUA submitted that the costs of unbundling are primarily transactional and are driven by the number of customers being served. In IGUA's opinion, there is no reasonable basis for using a volume-related allocation factor to recover the costs.

London Property Management Association

- 5.37 LPMA argued that the total unbundling cost, \$15.7 million, should be split into two parts and each treated differently. LPMA submitted that the \$7.5 million of phase 1 costs were incurred during the design phase and will benefit both large and small customers. LPMA argued that this amount should be amortized over a period determined by the Board, as the benefits will be realized over the long term. The \$8.2 million of phase 2 costs were, it stated, incurred during the implementation phase to benefit only the unbundled, small volume customers and they should be recovered through a rate rider applicable to small volume unbundled customers (i.e. U2 and S1 customers). LPMA argued that Union's shareholder should bear the risk for any unrecovered balances. LPMA supported Union's proposal to recover the cost of the customer communication/information program from the small volume customers that may benefit from the further unbundling.

Vulnerable Energy Consumers Coalition

- 5.38 VECC questioned the prudence of Union's unbundling costs and argued that Union did not exercise due diligence to ensure that the proposed systems are used and useful or to inform the stakeholders of increasing costs. VECC argued that Union not be allowed to recover the \$15.7 million of projected costs from ratepayers at this time.

Rather, Union should re-apply for recovery of these amounts through rates and support such a future application with substantiated evidence justifying the prudence of the unbundling costs.

- 5.39 VECC argued against recovering these costs from customers who do not choose unbundled service as small volume end-use customers are not guaranteed to receive potential savings arising from the unbundling of services and that industrial customers will use some system functionalities (eg., the clearinghouse, daily nominations) more extensively than will small volume customers. If the Board were to deem unbundling beneficial for market place restructuring, VECC argued that costs should be allocated on a volumetric basis.

Wholesale Gas Service Purchasers Group

- 5.40 WGSPG submitted that the Board should review and allocate the unbundling costs separately based upon the two unbundling phases:
- the \$7.5 million incurred in the first phase of unbundling should be allocated to all in-franchise rate classes according to a weighted average number of customers allocation factor as development costs are related to the number of customers, not the volume; and,
 - the \$8.2 million incurred in the second phase should be allocated entirely to the general service customer (rates M2, 01, 10), further no portion of these phase 2 costs should be recovered from customers of either the M9 or M10 rate classes.

The Cities of Greater Sudbury and Timmins

- 5.41 The Cities argued that not all the costs were prudently incurred. They stated that the justification of the level of unbundling cost and the absence of cost-benefit analysis were not satisfactory. The Cities proposed that the Board allocate a portion of the costs to Union's shareholder and that there is no justification for discrimination on the basis of location between customers of effectively the same class. The Cities argued that the customer number allocation approach proposed by Union recovers a disproportionately large amount from small volume customers in Greater Sudbury

and Timmins. The Cities argued that the costs should be amortized over more than one year as there is no assurance that these services will be used.

Union's Reply Argument

5.42 Union reiterated that the costs it had incurred to implement the unbundled services and split billing were prudent and that its proposed recovery was appropriate.

5.43 Union disputed the position of some intervenors that unbundled storage services were not desired by the market, and in particular the small volume market. Union considered it too early to tell whether the market is interested in unbundled services, stating that these services have been available for only approximately 6 months in the large volume market. Union reminded the Board that some small volume market representatives supported the RP-1999-0017 Settlement Agreement and that the largest marketer has written Union that it intends to take the unbundled service when it is available. Union characterized its contact with marketers during the unbundled storage service development period as appropriate. Union defended its provision of this service on the grounds that it will be desired and used in the future.

5.44 With respect to CEED's concerns about cross-subsidization, Union submitted that the billing-for-storage costs included in the incremental enabling unbundling costs are, in reality, costs related to the two-way electronic communication capability which is central to the enabling unbundling systems activity.

5.3 BOARD FINDINGS

5.3.1 Observations on the Alternative Dispute Resolution Process

5.45 In their submissions on the question of prudence, some parties placed great importance and emphasis on the fact that the development of the provision of unbundled storage services for the low volume customer was agreed to as part of the Settlement Agreement in the RP-1999-0017 case.

- 5.46 In this case, parties sought to characterize the terms of the Settlement Agreement in the RP-1999-0017 case in various ways, depending in part on their differing points of view as to what it was that was actually agreed to in that agreement, or in light of changed circumstances and current objectives.
- 5.47 The Board recognizes that the ADR process has become an integral part of most major applications. Through the ADR process, parties are able to resolve issues through negotiation rather than litigation before the Board, often resulting in cost effective solutions acceptable to the Board and a more focussed, efficient regulatory process.
- 5.48 The ADR process is not, however, a substitute for the Board's deliberation. In fulfilling its statutory mandate, the Board must be mindful of a range of considerations which do not necessarily influence private parties in their attempts to resolve differences.
- 5.49 The Board may accept a settlement agreement in its totality and accept the cost consequences flowing from it in the same way. However, in the Board's understanding, settlement agreements are not drafted with the kind of care associated with, for example, commercial agreements which are intended to be rigorously enforced. Hence, the agreements typically are not susceptible to close and precise interpretation and, therefore, the Board should not be considered to have endorsed separately each element of an approved settlement agreement.
- 5.50 On the other hand, parties to settlement agreements will generally be considered by the Board to have accepted their terms. Acceptance of some individual elements may have been traded off against acceptance of other elements. Parties ought not to be able to disassociate themselves lightly from such agreements.
- 5.51 The Board notes that the specific provisions of the settlement agreements are drafted by the parties to the agreements. It is incumbent on the parties to ensure that the wording of the agreement reflects what they have agreed.

5.3.2 **Quantum and Prudence of Incremental Costs of Unbundling Services and Rates for Small Volume Customers**

- 5.52 The essential aspect of a review of prudence is to examine what factors were reasonable for the utility to take into account at the time the decision being reviewed was made and whether the decision was prudent in light of those factors. Hindsight is not relevant to such a review.
- 5.53 The Board's consideration of the prudence of Union's expenditures has been dealt with by asking two questions:
- was there a need for the proposed system changes, demonstrated through a demand for specific services or by a consensus that a change in the current general provision of service was desired? If so,
 - is the quantum of the proposed expenditure appropriate and acceptable and hence recoverable in rates?
- 5.54 To address the first question, the Board has found it necessary to address the role of the ADR process and the resulting settlement agreement in the Board's decision making, and has done so above.
- 5.55 In any case where a utility seeks to have the costs associated with its activities passed on to ratepayers, the public anticipates a candid and accurate assessment of the appropriateness of that treatment. The exposition required to support such proposed cost recovery should include a description of the contractor selection process, a listing and evaluation of the options considered, a detailed description of the product procured and its functionality, and a demonstration of its usefulness to ratepayers.
- 5.56 In this case, intervenors have challenged the expenditures claimed in the IUCDA on the grounds that Union should have conducted a cost-benefit study prior to embarking on the development; and that Union has not demonstrated that the provision of the unbundled services is, or is likely to be, used or useful to consumers or marketers.

- 5.57 The preparation of a cost-benefit study, or at least a study of cost alternatives, would in many instances be a pre-condition to any claim respecting the prudence of expenditures. However, there are cases where a cost-benefit study may be unnecessary. There is little justification for a cost-benefit study where there was a clear and pressing consensus, developed under the auspices of the regulator, that the enabling of the provision of unbundled services was a necessary next step in the development of the competitive gas market in Ontario.
- 5.58 The question as to whether the unbundled services will be used or useful to the consumer involves speculation. What is not speculative is the consensus which formed around this issue through the Market Design Task Force and the Settlement Agreement in the RP-1999-0017 case. The existence of this consensus at the time Union undertook this systems development is a principal factor in explaining why Union proceeded.
- 5.59 Accordingly, the Board is satisfied that the enabling of the provision of the unbundled services through the development of redesigned systems was appropriate, even in the absence of a cost-benefit study and any further documented expression of interest on the part of any consumer or marketer. The Board considers the unbundling activity to be a necessary stage in the evolution of the market, notwithstanding the absence of express interest in certain unbundled services at this time.
- 5.60 The Board notes the concern expressed by some intervenors, that the monies committed to enable the unbundled services grew from an original estimate of \$5 million in 1999 to \$7.5 million in 2000, to an ultimate total of \$15.7 million for disposal in this proceeding. Union described the developed systems in fairly general terms. There was limited examination of the scope and content of the systems developed, and the degree to which the systems may serve purposes other than those exclusively related to enabling the offering of unbundled services. The Board's assessment of prudence would have profited from a more detailed description of the functionality of the systems, and any crossover application to Union's operations unrelated to enabling the offering of unbundled services.

5.61 With respect to CEED's concerns about cross-subsidization, there is no basis upon which the Board could identify what portion of billing costs could be attributed to in-franchise and to ex-franchise storage customers. In the context that the incremental unbundling costs are costs of a transition to a more competitive commodity market, the broad allocation of these costs over all rate payers has merit. Any concern which CEED may have about the allocation of ongoing billing costs to storage may properly be reviewed when Union next files a cost allocation study.

5.62 In response to Kitchener's concern that the proposed system changes may result in cost savings to Union, the Board is aware of no evidence in this proceeding that would allow it to quantify any such savings. Furthermore, Union asserts that there will be no such savings. The Board notes that, to some extent, the earnings-sharing mechanism approved by the Board in RP-1999-0017 may address Kitchener's concern.

5.63 The Board accepts that the proposed systems will be competent to provide functionalities to enable small volume customers to access unbundled services, either directly or indirectly through marketers. Union's representatives have testified to the level and purpose of the costs of enabling of unbundling and the Board is not persuaded that the costs have been imprudently incurred. The Board approves of the recovery of the costs recorded in the IUCDA incurred to enable the unbundling of services and rates to serve the small volume market, having been forecast to be \$15.7 million.

5.3.3 Allocation of Responsibility for Recovery of Incremental Costs of Enabling Unbundling of Services and Rates

5.64 The Board recognizes that the unbundling costs at issue in this proceeding are expected to result in increased competition in the gas commodity market to the benefit of all natural gas consumers. Union incurred costs of \$7.5 million during phase 1 in order to design unbundled storage services and to make available competitive options for all small volume customers.

- 5.65 An important element of the value of the proposed system changes is the ability of the proposed changes to be leveraged to enable marketer-consolidated billing and other services in the future and without significant further design, expenditure or delay. The Board expects that the systems developed to enable access to unbundled services, and which are the subject of this proceeding, will be able to be relied upon to accommodate marketer-consolidated billing without significant system change or significant additional expenditure, in the event that such functionality may be required.
- 5.66 Increased competition in the gas commodity market may lead to reduced prices for the commodity for all purchasers of natural gas in the Union franchise area. This outcome, should it occur, would have system-wide implications for all consumers. Large volume customers would benefit to a larger extent in absolute terms from lower commodity costs. In the Board's view, the costs incurred to achieve the benefit of a lower commodity price should be paid for by all customers and, specifically, that these costs should be recovered through a volumetric charge.
- 5.67 The Board directs Union to recover the costs of the first phase, being \$7.5 million, on a volumetric basis from all customers.
- 5.68 It is Union's evidence that the costs of the second phase were incurred to provide unbundled service solely to small volume customers and that the systems and process modifications would not replace any existing services. There is no evidence in this proceeding to directly link the cost of the second phase to the large volume customers. In considering the treatment of the costs of the second phase, it is the Board's view that the purpose for which a system was designed is not, in itself, determinative of how the costs should be recovered. However, one benefit of these new systems is Union's ability to process many more transactions. The Board is prepared to recognize this by approving a transaction-based recovery approach for the cost of the second phase, being \$8.2 million.
- 5.69 The Board understands that the new systems are equally necessary for determining nominations for system gas customers, as a group, as they are for each marketer's group of gas customers. In other words, once consumers, other than independent

large customers, must be grouped for nomination purposes, no group has a particular claim to being the residual group for which nominations are implicitly determined. Therefore, there should be no distinction between those small volume consumers which purchase their gas from marketers and those which do not.

5.70 The Board is satisfied that it is fair to recover the costs of the second phase from the small volume customers in relation to the transaction load they impose on the business systems. The Board is satisfied that the weighted average number of small volume customers is an appropriate measure of this transaction load. In the Board's view an appropriate weighted average number of customers to use for this purpose is Union's current 12 month forecast.

5.3.4 Comprehensive Customer Information Program Deferral Account

5.71 The Board finds that Union's proposed expenditures of \$550,000 to be recorded in the CCIPDA are prudent and Union's proposed recovery is appropriate. The Board considers that effective competition in the commodity market requires consumers which are informed and knowledgeable about transactions in the commodity and the services related to its delivery. The Board is of the view that consumer communications vary directly with the number of consumers and so approves Union's recovery of the balance of this account on the basis of the weighted-average number of small volume consumers.

6. IMPLEMENTATION AND OTHER MATTERS

6.1 RATE SCHEDULE CHANGES

- 6.1 The recovery of the incremental unbundling costs and the customer information costs are costs not anticipated to be covered in the price cap under the PBR mechanisms approved by the Board. Such costs and related issues might under other circumstances have been dealt with in an annual customer review process. In the Board's view, there is merit in implementing changes to rate schedules associated with this Decision at the same time as changes are implemented in RP-2001-0029, Union's first Customer Review Process proceeding.
- 6.2 Implementing changes resulting from this proceeding together with changes required in RP-2001-0029 will reduce the number of rate changes to which customers will be exposed and moreover may permit certain changes to be combined and their effects to be more appropriately mitigated where necessary.
- 6.3 The Board directs Union to implement changes to rate schedules resulting from this Decision at the same time as it implements any rate schedule changes arising from the Board's decision in the RP-2001-0029 proceeding.
- 6.4 During the hearing, the Board questioned the clarity of the descriptions and terms used in the proposed rate schedules. The Board expects Union to revise its rate schedules to address the Board's concerns in respect of clarity and ease of understanding as discussed in the transcript of the hearing on February 26, 2002 (ERF reference: 128R1-2:488). On implementation of this Decision, the Board requires that Union provide updated rate schedules supported by detailed working papers explaining the disposition and recovery of the balances recorded in the IUCDA and the CCIPDA.

6.2 LOAD BALANCING AND FLEXIBILITY COSTS

- 6.5 With respect to the concerns of Direct Energy, CEED, and Kitchener and the request that the issue of load balancing and flexibility be addressed in the upcoming Customer Review Process for 2003, the Board finds that Union should address the issue of load balancing and flexibility costs as soon as practicable and, if possible, during Union's 2003 Customer Review Process. If Union does not deal with this matter in that proceeding the Board may nonetheless find it appropriate to receive submissions from others on this issue, on matters of both content and procedure.

6.3 COST AWARDS

- 6.6 The Board will issue its decision on cost awards in due course.

DATED at Toronto, July 31, 2002

Malcolm Jackson
Presiding Member

George A. Dominy
Member

Paul B. Sommerville
Member

APPENDIX A

RP-2000-0078

ISSUES LIST

as approved by the Board June 6, 2001

APPENDIX B

RP-2000-0078

SETTLEMENT PROPOSAL

as agreed to by parties January 28, 2002