1

RP-2002-0133

2

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15 (Schedule B);

3

AND IN THE MATTER OF an Application by Enbridge Gas Distribution Inc. for an Order or Orders approving or fixing just and reasonable rates for the sale, distribution, transmission and storage of gas for its 2003 fiscal year.

4

BEFORE:

5

Bob Betts
Presiding Member

6

George A. Dominy
Member

7

DECISION WITH REASONS

8

November 7, 2003

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1 INTRODUCTION

1.1 The Application

Enbridge Gas Distribution Inc. ("EGDI", "Enbridge", the "Company" or the "Applicant") filed an application dated September 2, 2002 (the "Application") with the Ontario Energy Board (the "Board") under section 36 of the *Ontario Energy Board Act*, 1998 (the "Act" or the "OEB Act"), for an order or orders approving or fixing just and reasonable rates for the sale, distribution, transmission, and storage of gas for EGDI's 2003 fiscal year commencing October 1, 2002 ("2003 Test Year" or "Test Year" or "fiscal 2003"). The Board assigned file number RP-2002-0133 to the Application.

1.2 The Proceeding

On September 27, 2002 the Board issued an Interim Order in which it declared the existing rates to be interim effective October 1, 2002 for a period no longer than one year.

On September 30, 2002 the Board issued a Notice of Application, which was published and served in accordance with the Board's direction during the month of October 2002.

On October 30, 2002 the Board issued Procedural Order No. 1 establishing the procedural schedule for all events prior to the oral hearing. These events included:

- a stakeholder conference on November 13, 2002;
- written interrogatories of the Applicant by November 20, 2002;
- interrogatory responses from the Applicant by December 11, 2002;
- an Issues Conference on December 17, 2002;
- an Issues Day proceeding on December 19, 2002;
- supplementary written interrogatories of the Applicant by January 2, 2003;
- supplementary interrogatory responses from the Applicant by January 9, 2003;
- intervenor evidence to be filed by January 13, 2003;

28

- written interrogatories of intervenor evidence by January 20, 2003;

29

- interrogatory responses from intervenors by February 3, 2003;

30

- a Settlement Conference beginning February 11, 2003 ("Settlement Conference"), and

31

- a Settlement Proposal filed with the Board on March 7, 2003 ("Settlement Proposal").

32

In response to Procedural Order No. 1, the Board received written evidence prepared by the following parties:

33

- Dr. Johannes Bauer on behalf of the Consumers' Association of Canada ("CAC"), Industrial Gas Users' Association ("IGUA"), and the Vulnerable Energy Consumers Coalition ("VECC");

34

- Malcolm Rowan on behalf of Canadian Manufacturers & Exporters ("CME");

35

- Norman Rubin on behalf of Energy Probe ("Energy Probe");

36

- Chris Neme on behalf of Green Energy Coalition ("GEC") and the Canadian Institute for Environmental Law and Policy ("CIELAP");

37

- John Bergsma on behalf of the Heating, Ventilation and Air Conditioning Coalition Inc. ("HVAC");

38

- evidence submitted on behalf of IGUA;

39

- Carla Kisko and Donald L. Higgins on behalf of the Ontario Public School Boards Association ("School Boards"); and

40

- W. John Finch and Peter Zahakos on behalf of the Associated Toronto Taxicab Co-operative Limited ("Co-op Cabs") and the Canadian Natural Gas Vehicle Alliance.

41

Procedural Order No. 1 also indicated that the Board's review of the formula used to derive the rate of return on equity would be dealt with in a separate proceeding and would therefore not be considered in this proceeding.

42

Subsequent to the issuance of Procedural Order No. 1, the Board granted a three day extension to the filing deadline of November 20, 2002 for written interrogatories of the Applicant.

43

On Issues Day the Company suggested several scheduling adjustments for the process leading up to the Settlement Conference. These scheduling adjustments were accepted by the Board and were reflected in Procedural Order No. 2 issued on December 23, 2002.

44

Procedural Order No. 2 established the Issues List ("Issues List"), which is attached as Volume 2 Appendix A to this Decision with Reasons.

45

On March 7, 2003, the Board received a letter written on behalf of the parties in the Settlement Conference requesting an extension of the filing of the Settlement Proposal from the original date of March 7, 2003 to March 14, 2003.

46

The Board issued Procedural Order No. 3 on March 12, 2003 which set March 20, 2003 as the date for hearing the Settlement Proposal and March 24, 2003 as the commencement of the evidentiary phase of the oral hearing. The evidentiary phase of the oral hearing took place over 29 hearing days commencing March 24, 2003 and concluding on June 5, 2003. A number of in camera sessions were held to allow cross examination of witness panels on confidential matters.

47

During the course of the hearing, the parties agreed to the following schedule for filing their respective written arguments: Applicant's Argument-in-Chief - June 20, 2003; Intervenors' Arguments - July 4, 2003; and, Applicant's Reply Argument - July 18, 2003.

48

1.3 Demand Side Management (DSM)

49

The Board issued its written "Partial Decision with Reasons" on August 19, 2003 pertaining to the DSM issues in the RP-2002-0133 proceeding (and some DSM issues from the Company's RP-2001-0032 proceeding). This decision is available in the Board's Public File Room and on the Board's website.

50

1.4 Quarterly Rate Adjustment Mechanism

51

EGDI made four separate applications to the Board and the Board issued interim orders to implement, effective October 1, 2002, January 1, 2003, April 1, 2003 and July 1, 2003, adjustments to EGDI's commodity rates under a quarterly rate adjustment mechanism ("QRAM"). These applications were substantially in the form approved by the Board as part of the 2001 settlement proposal in the RP-2000-0040 proceeding for setting rates for EGDI's 2001 fiscal year.

52

The QRAM applications were assigned the following file numbers under the main Application RP-2002-0133:

53

- EB-2002-0431 (relating to the October 1, 2002 QRAM);

54

- EB-2002-0494 (relating to the January 1, 2003 QRAM);

55

- EB-2003-0032 (relating to the April 1, 2003 QRAM); and

56

- EB-2003-0126 (relating to the July 1, 2003 QRAM).

57

The complete record for each of the QRAM proceedings, including the application, submissions, hearing transcripts for the July 1, 2003 application and the Board's Decision and Order can be found under the respective QRAM docket numbers listed above.

58

1.5 Interim Rate Request

59

By letter dated November 25, 2002, EGDI requested that the Board make an interim rate determination with respect to the Application due to the prospect of a final rate order for the Test Year being many months after the Application's proposed effective date for a rate increase of October 1, 2002. The interim rates were proposed to be based on an Ontario inflation rate of 3.3% and would be applied to the delivery component of the rates. The interim rates would be effective on January 1, 2003.

60

The Board considered the matter and rejected the request in a letter dated December 6, 2002, citing its concern about the timing of the Application and that the issue of retroactive rate making was one that needed to be addressed in the main proceeding. The Board also expressed its concern about the inappropriate use of the QRAM process to effect such a rate change.

61

1.6 Settlement Conference

62

The Settlement Conference was conducted over 17 days commencing February 11, 2003 and concluded on March 7, 2003.

63

1.7 Motion by Direct Energy

64

Direct Energy Marketing Ltd., an intervenor registered in the proceeding, filed a Notice of Motion with the Board on March 19, 2003. The relief sought was primarily to have the filed evidence of John Bergsma, submitted on behalf of HVAC, struck from the record. The Board requested written submissions on March 24, 2003 and March 25, 2003 with reply submissions on March 26, 2003. The Board issued its oral Decision on the Motion on March 28, 2003 in which it allowed the evidence to stay on the record with the restriction that the Board would only consider the rate consequences flowing from the arrangements between EGDI and CustomerWorks Limited Partnership ("CWLP").

65

1.8 Motion by CAC, IGUA and VECC

66

The Board received on March 27, 2003 a written motion filed collectively by CAC, IGUA and VECC requesting the disclosure of documents by affiliates of the Company and other parties ("Disclosure Motion"). The Board heard oral submissions on the Disclosure Motion on April 8, 2003 and April 9, 2003. The Board issued a written Decision and Order on the matter on April 15, 2003 in which the Board ordered the production of information concerning the rationale for outsourcing and information on the costs of certain of the outsourced service providers. The Board rendered its second Decision and Order orally on May 1, 2003 after hearing additional submissions on the Disclosure Motion on April 29, 2003, April 30, 2003 and May 1, 2003. In the second Decision and Order, the Board ordered the production of documents relating to strategic planning for outsourcing and a report on the Company's O&M savings in relation to outsourced functions. The documents that were the subject of the production Orders were produced by May 15, 2003.

67

Subsequent to the Board's May 1, 2003 oral Decision and Order, CWLP, Enbridge Inc. ("EI"), Enbridge Commercial Services Inc. ("ECSI"), Enbridge Operational Services Inc. ("EOS") and Enbridge Gas Services Inc. ("EGS") filed appeals to the Ontario Divisional Court from the Orders made by the Board on April 15, 2003 and May 1, 2003 asserting that the Board lacked the jurisdiction to make orders requiring production of documents from non-parties. These appeals remain outstanding.

68

On May 13, 2003, the Board served its summons for appearance, including production of the documents referenced in the Orders of April 15, 2003 and May 1, 2003, on a representative of EI and a representative of CustomerWorks Inc. ("CWI"). The Board withdrew the summonses on May 16, 2003 on the basis that the Board's evidentiary needs had been fulfilled.

69

1.9 Motion by CAC

70

On May 1, 2003, CAC brought an oral motion requesting that the Company produce the contract to outsource support for the Work and Asset Management Solution ("WAMS") project to Accenture Inc., an application service provider. The Board issued its oral decision on the same day and rejected CAC's motion because the Board viewed the 2003 costs associated with WAMS as a settled issue for the purposes of this proceeding.

71

1.10 Decision on EnTRAC during Oral Hearing

72

The Company requested that the Board hear the Energy Transaction, Reporting, Accounting and Contracting (EnTRAC) information technology project issue and render an early Decision on the issue so that the Company could proceed with the EnTRAC project as soon as possible. In the Settlement Proposal, the parties agreed to examine this unsettled issue early in the hearing and the Board accepted this proposal. The Board heard oral arguments from the parties on April 1, 2003 and April 2, 2003 and issued its oral decision on the EnTRAC project (Issue 6.4) on April 16, 2003. The verbatim text of the oral decision is included in this Decision with Reasons.

73

1.11 Participants and their Representatives

74

Below is a list of participants and their representatives that were active either at the oral hearing or at another stage of the proceeding.

75

Board Counsel and Staff	Pat Moran, Colin Schuch, Suzanne Tong, Chris Mackie, Turgut Hassan
Enbridge Gas Distribution Inc.	Fred Cass, Dennis O'Leary, Helen Newland, Tania Persad, Marika Hare, Tom Ladanyi
Canadian Manufacturers & Exporters ("CME")	Bruce MacOdrum, Malcolm Rowan
Green Energy Coalition and the Canadian Institute for Environmental Law and Policy (collectively "GEC")	David Poch, Kai Millyard
The Ontario Association of School Business Officials (the "Schools")	Tom Brett
Heating, Ventilation and Air Conditioning Contractors Coalition Inc. ("HVAC")	Brian Dingwall
TransCanada PipeLines Limited ("TCPL")	Tibor Haynal
Consumers' Association of Canada ("CAC")	Robert Warren, Julie Girvan
Vulnerable Energy Consumers Coalition ("VECC")	Michael Janigan, Susan Lott, Roger Higgin, Gail Morrison, Judy Kwik, Joyce Poon
Coalition for Efficient Energy Distribution ("CEED")	Elisabeth DeMarco
Pollution Probe Foundation ("Pollution Probe")	Murray Klippenstein, Jack Gibbons
Industrial Gas Users Association ("IGUA")	Vince De Rose, Peter Thompson
Ontario Public School Boards' Association ("School Boards")	Jay Shepherd, John Bell, Danielle Young
Direct Energy Marketing Ltd. ("Direct Energy")	Ian Mondrow, Bill Killeen, Melanie Aitken, John Rook
Energy Probe Research Foundation ("Energy Probe")	Mark Mattson, Craig Parry, Tom Adams, David MacIntosh
Ontario Energy Savings Corporation ("OESC")	Jim Hamilton
Union Gas Limited ("Union")	Pat McMahon, Crawford Smith
Enbridge Inc., Enbridge Commercial Services Inc., Enbridge Gas Services Inc. and Enbridge Operational Services Inc.	Elizabeth Stewart
CustomerWorks Inc. ("CWI")	Robert Howe, Janet Clark
CustomerWorks LP ("CWLP")	John Sproat

76

Witnesses

77

There were a total of 40 witnesses who testified at the oral hearing.

78

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

79

Robert Bourke	Manager, Regulatory Accounting
Mark Boyce	Associate General Counsel & Corporate Secretary
Frank Brennan	Director, Energy Policy & Analysis
Lloyd Chiotti	General Manager, Central Region
Dave Charleson	Manager, Strategic and Key Accounts
Susan Clinesmith	Manager, Business Market Programs
Jackie Collier	Manager, Rate Research
Bill Cowan	Team Leader, Finance & Regulatory
George DeWolf	Director, Information Technology
Pascale Duguay	Manager, Rate Research and Design
Malini Giridhar	Manager, Rate Design
Jane Haberbusch	Director, Human Resources
Cathy Hanlon	Manager, Residential, Commercial and New Construction Market Programs
Janet Holder	Vice President, Operations
Tom Ladanyi	Manager, Regulatory Proceedings
Kerry Lakatos-Hayward	Manager, Business & Financial Analysis
Steve McGill	Manager, Strategic Projects
Michael Mees	Assistant Controller
Scott Player	Vice President, Finance
Norm Ryckman	Manager, Utility Planning and Evaluation
Don Small	Manager, Gas Cost Knowledge Center
Pat Squires	Manager, DSM and Program Evaluation

80

In addition, the Company called the following witnesses:

81

Ann Wilson	President, Cum Pane Consulting
Judy Simon	Vice-President, IndEco Strategic Consulting Inc.
Todd Williams	Principal, Navigant Consulting Ltd. (Toronto)
David Heeney	President, IndEco Strategic Consulting Inc.
Bob Turner	Partner, Ernst & Young
Scott Wilson	Senior Vice President, Finance, Enbridge Inc.
Karyn Brooks	Vice President & Controller, Enbridge Inc.
Bonnie Dupont	Group Vice President, Corporate Resources, Enbridge Inc.
Duncan Kent	Vice President & Chief Information Officer, Enbridge Inc.
Stephen Letwin	Group Vice President, Gas Strategy and Corporate Development, Enbridge Inc.
Rudy Riedl	President, R.G. Riedl Consulting Inc.
Douglas Louth	Douglas Louth Associates Inc.
Dr. Mark Lowry	Partner, Pacific Economics Group

82

CME called the following witness:

83

Malcolm Rowan	Rowan & Associates Inc.

84 CAC, IGUA and VECC called the following witness:

85

Dr. Johannes Bauer	Professor, Michigan State University

86 Energy Probe called the following witness:

87

Norman Rubin	Senior Policy Analyst, Energy Probe

88 IGUA called the following witness:

89

Peter Fournier	President, IGUA

90 GEC called the following witness:

91

Chris Neme	Director of Planning & Evaluation, Vermont Energy Investment Corporation

92

1.12 The Settlement Proposal

93 The Settlement Proposal was filed with the Board on March 14, 2003. A copy of the 93-page Settlement Proposal is attached as Volume 2 Appendix B to this Decision with Reasons.

94 Of the 87 issues on the Issues List, the Settlement Proposal included complete settlement of 65 issues and it indicated that parties would not address these issues at the hearing. The remaining issues fall into one of the following three categories:

95
- complete Settlement (7 issues - only certain policy aspects to be addressed at the hearing);

96
- partial Settlement (5 issues - full issue to be addressed at the hearing); and

97

- no Settlement (10 issues - full issue to be addressed at the hearing).

98

The issues for consideration at the hearing, as categorized above, were:

99

Complete Settlement

100

Issue 2.1 Enbridge Gas Distribution Inc.'s proposals for changes in the level of service charges.

101

Issue 7.2 A comparison of the budget process followed during the years 1999 - 2002 inclusive, and 2003.

102

Issue 7.3 The expense reductions achieved during the years 1999, 2000, 2001 and 2002, and the criteria for deciding whether those expense reductions are sustainable.

103

Issue 7.4 Where and how efficiency gains, and the benefits of efficiency gains, are realized in each of the years 2000, 2001 and 2002.

104

Issue 7.5 The appropriateness and evaluation of the benchmarking evidence to assess O&M costs.

105

Issue 7.43 Cost allocations to Enbridge Gas Distribution Inc. from the EI corporate office including changes in the scope of services provided.

106

Issue 7.44 Enbridge Gas Distribution Inc.'s O&M budget for the Distribution Plant Work and Asset Management Solution (DPWAMS) information technology project.

107

Partial Settlement

108

Issue 9.1 Enbridge Gas Distribution Inc.'s DSM Plan for the 2003 Test Year, including the O&M budget and the volume target.

109

Issue 9.2 Review of the Shared Savings Mechanism (SSM) incentive scheme.

110

Issue 9.3 Review of the proposed new framework for DSM for the 2003 Test Year and beyond, including the requested one-time budget amount of $790,000.

111

Issue 9.4 Review of the DSM Consultative Process.

112

Issue 9.5 Review of the DSM Audit Process.

113

No Settlement

114

Issue 6.4 Enbridge Gas Distribution Inc.'s Energy Transaction, Reporting, Accounting and Contracting (EnTRAC) information technology project.

115

Issue 7.45 Unresolved policy aspects of specific issues relating to O&M.

116

Issue 8.1 Outsourcing arrangements for 2003.

117

Issue 8.2 General policies regarding outsourcing and the pricing of such services, including the terms, conditions and monitoring of subcontractors performing utility services.

118

Issue 8.3 Cost and other implications of Enbridge Gas Distribution Inc.'s agreements with CustomerWorks Limited Partnership for the provision of customer care services, including a review of the Douglas Louth report.

119

Issue 8.4 Cost and other implications of Enbridge Gas Distribution Inc.'s agreements with Enbridge Operational Services Inc. (EOS) for Gas Supply Operations.

120

Issue 8.5 Cost and other implications of Enbridge Gas Distribution Inc.'s agreements with Enbridge Gas Services Inc. for Gas Supply Services and Transactional Services.

121

Issue 8.6 Reasonableness of O&M Expenses Enbridge Gas Distribution Inc. seeks to recover from ratepayers for services which have been outsourced initially to affiliates or related parties and then to third party service providers.

122

Issue 8.7 The implications of the Board's 2002 Test Year Decision.

123

Issue 13.1 Proposals or options to minimize rate retroactivity.

124

Issue 9.6: Recovery of SSM and LRAM balances for 2000 and 2001(subject of Dec/2002 SSM ADR Settlement Conference) - is not included on the above list because it was negotiated in a separate settlement conference held for that purpose in December 2002. That settlement conference arose out of a Board commitment made in the RP-2001-0032 proceeding dealing with the Company's fiscal 2002 rates application whereby the Board directed a settlement conference for 2000 and 2001 SSM and LRAM. A partial settlement proposal was filed with the Board on December 23, 2002. The Board subsequently decided to hear the Issue 9.6 settlement proposal in the RP-2002-0133 proceeding.

125

On March 20, 2003 counsel for EGDI explained the Settlement Proposal to the Board. On the same day, the Board accepted the Settlement Proposal for rate making purposes for the 2003 Test Year.

126

The Settlement Proposal included the financial impact statements relating to the Settlement Proposal. The financial statements reflecting the financial impact of the Settlement Proposal and forming the basis of the final rates are attached as Volume 2 Appendix C to this Decision with Reasons.

127

1.13 Final Rate Order

128

The Settlement Proposal represented a comprehensive financial settlement from a rate making perspective. The Board's acceptance of the Settlement Proposal on March 20, 2003 enabled the resulting rates to be implemented as final rates on May 1, 2003. In keeping with this implementation date, the Company filed the Draft Final Rate Order on April 3, 2003 and the Board allowed parties to comment by April 16, 2003.

129

The Board issued its Final Rate Order for the 2003 Test Year ("Final Rate Order") on April 29, 2003 and the new rates became effective on May 1, 2003. The Final Rate Order included a retroactive adjustment to the commencement of the 2003 Test Year, October 1, 2002, and also included the clearance of the fiscal 2002 deferral and variance accounts. Both of these elements were features contemplated in the Settlement Proposal.

130

1.14 Submissions and Exhibits

131

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

132

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

133

2 OUTSOURCING ARRANGEMENTS, EFFICIENCY GAINS AND O&M POLICY ISSUES

134

The essence of the issue under consideration in this chapter is whether the $270 million amount that was agreed to in the Settlement Proposal for the Company's 2003 O&M expense adequately reflects the full extent of cost efficiencies, or productivity improvements, that intervenors claim were transferred by the utility to affiliated service providers over the last few years, rather than being passed on to utility ratepayers. In order to demonstrate and give effect to their claim, the intervenors have requested that an O&M deferral account be set up to record an amount that would represent the efficiency transfers. In effect, this would serve to reduce the $270 million O&M. The Company did not agree that any amounts are appropriate for the O&M deferral account.

135

2.1 Background

136

Over the past 5 years, Enbridge Gas Distribution Inc. underwent a significant business transformation. In 1998, the Company was an integrated natural gas utility, with a total workforce of about 3,750 employees. It provided gas distribution services, commodity sales, furnace and water heater rentals, appliance sales and service, and other associated services, to about 1.3 million customers. By 2003, the Company had transformed itself into a pure natural gas distribution utility, with a workforce of approximately 1,800 employees, about one half of its former size. It now provides gas distribution services to about 1.6 million customers and commodity sales service to about 830,000 customers, about 90% of whom are residential customers. EGDI also continues to own and operate a major natural gas storage facility near Corunna, Ontario.

137

In 1999, the competitive businesses of furnace and water heater rentals, appliance rentals and service, and heating parts replacement were transferred to an affiliate, Enbridge Services Inc. ("ESI"). Approximately 570 employees moved to ESI as part of that transaction.

138

In 2000, another affiliate, Enbridge Commercial Services Inc. ("ECSI"), was established to provide customer care and other services to both the utility and ESI. The customer care functions transferred to ECSI included billing, collections and the call centre. Other functions transferred to ECSI included fleet management and information technology. Approximately 1,100 employees were transferred to ECSI as part of that transaction.

139

At the time of the transfer of business functions and activities to ECSI, some other business functions of the utility were consolidated with similar functions at Enbridge Inc., the corporate parent. About 50 employees in the functions of human resources, finance, tax, internal audit, risk management and public affairs transferred to Enbridge Inc. Later in 2000, gas operations and control functions were also transferred to Enbridge Inc.

140

In 2001, ECSI entered into a limited partnership agreement with B.C. Gas Inc.(now Terasen Gas Inc.) to form CWLP, the purpose of which was to provide customer care services to the Company, B.C. Gas Utility Ltd. (“B.C. Gas” or “B.C. Gas Utility”), ESI and potentially other arm’s length parties. The partnership ownership is split 70/30 (ECSI/B.C. Gas). In May 2002, ESI was sold by Enbridge Inc. to an affiliate of Centrica plc. Following this sale, ECSI no longer provided fleet management services to ESI and those functions were transferred back to the Company. Also, employees of ECSI providing information technology services were split, with some moving to Centrica, some moving to CWLP and some staying with ECSI. Since ECSI would be providing information technology services almost exclusively to the utility, a group of ECSI employees performing such services was recombined with the utility effective October 1, 2002. ECSI provides CIS services to CWLP.

141

In July 2002, CWLP entered into an agreement with a 100%-owned affiliate of Accenture Inc. (“Accenture”), a provider of utility customer care services. The Accenture affiliate, CustomerWorks Inc. (“CWI”), assumed responsibility for the customer service obligations of CWLP and approximately 1,100 employees of CWLP became employees of Accenture. The service contracts between the Company and CWLP continue today. In 2003, the utility will pay approximately $100 million for customer care services provided by CWLP.

142

The Company also transferred its gas control functions to Enbridge Operational Services Inc. (“EOS”) in Edmonton, Alberta. On October 1, 2000, the Company entered into an agreement with EOS whereby EOS agreed to provide services to the Company in the areas of gas control, nominations and scheduling, and reconciliations. EOS provides these services to other companies (such as Vector Pipeline Limited) and its objective is to provide services on a third party basis to additional customers.

143

Another outsourcing arrangement undertaken by the Company was the transfer of gas supply functions to Enbridge Gas Services (“EGS”). On July 1, 2001, the Company appointed Enbridge Inc. as its agent to provide services such as gas supply planning, gas supply acquisition, risk management and transactional services. Subsequently, EGS was incorporated and, on October 1, 2002, the Company appointed EGS as its agent to perform all of the services in this area that had been provided under the agency agreement with Enbridge Inc.

144

In the course of the rate case, the Company filed the commercial contracts and service agreements supporting the utility’s outsourcing arrangements.

145

2.2 The Issue

146

The Board established the Company’s 3-year targeted performance-based regulation (“TPBR”) plan in its EBRO 497-01 Decision dated April 22, 1999. The TPBR plan expired immediately prior to the 2003 Test Year.

147

The Company’s 2003 Test Year application was filed as a full cost-of service rate filing, including a detailed department-by-department Operations and Maintenance Budget (“O&M budget” or

"O&M"). Neither the intervenors nor the Board had an opportunity to review a detailed O&M Budget from the Company since 1999 because for rate regulation purposes, the Company had been operating under the TPBR plan for the years 2000, 2001 and 2002. The TPBR plan was described as "targeted" because it applied to the utility's O&M expenses only, as opposed to other forms of incentive or performance-based ratemaking, such as a comprehensive PBR plan, in which the entire utility revenue requirement is adjusted under a formula.

148

In the EBRO 497-01 proceeding the Board was told by the Company that it envisioned benefits to ratepayers in its TPBR proposal. The Decision reads at paragraph 2.0.7:

149

> It was the Company's view that its proposal would produce four distinct benefits:

150

> 1. Guaranteed productivity benefits to ratepayers of $4.7 million and guaranteed service quality;

151

> 2. An incentive to the shareholder, for which the shareholder is at risk, to achieve greater than the $4.7 million of benefits guaranteed to ratepayers, without a decline in service quality;

152

> 3. Additional productivity benefits to ratepayers if, when rebasing occurs at the end of the plan period, the shareholder has achieved permanent savings greater than $4.7 million; and

153

> 4. Benefits to ratepayers and the Board by way of a simplified hearing process for the Company's rates applications during the plan period.

154

The TPBR plan allowed EGDI to recover an annual O&M allowance, established by formula starting with 1999 as the base, for each of the years 2000, 2001 and 2002. The Company did not file an O&M budget. It was not necessary under the TPBR plan; however, in large part, it was during this period that the Company was engaged in its business reorganization activities. With the expiry of the TPBR plan in 2002, the Company filed a cost-of service proposal, including an O&M Budget, for the 2003 Test Year.

155

EGDI's 2002 Board-approved O&M amount calculated under the TPBR plan was $259.9 million ($251.3 million from the formula plus $8.6 million from Z -factors) and the 2002 actual O&M spent was $246.4 million. The Company's 2003 O&M budget as filed with the Board increased to $305.1 million.

156

The large increase in the requested 2003 O&M amount, when compared to previous year's amounts, gave rise to many questions from intervenors about the reasonableness of the budget figures and the justification for such an overall increase. There were two primary concerns expressed. First, the preceding 3-year TPBR plan permitted none of the traditional regulatory scrutiny of the O&M Budget. Second, the significant outsourcing which took place at the utility during the TPBR plan period, much of it to affiliated companies, involved a transfer of O&M efficiency gains that,

according to the intervenors, should have stayed with the utility and its ratepayers, but were instead exported to the outsourced entities.

157

In the Settlement Proposal filed with the Board, the parties treated the total O&M expense as an “envelope” which is in contrast to a “bottom up” analysis of the O&M Budget which would have involved a line-by-line consideration of each operating department’s expense budget. The parties agreed to an O&M amount of $270 million plus a DSM budget of $10.9 million for a total O&M of $280.9 million subject to a deferral account for possible O&M efficiency gains.

158

The O&M Deferral Account (“2003 O&MDA” or “O&MDA”) was established, at the request of the intervenors, to capture any efficiency gains that were transferred by the Company to affiliates or related parties during the term of the TPBR plan.

159

Issue 7.1 of the Settlement Proposal, where the 2003 O&MDA is described, reads as follows:

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> Subject to the Board's determination of the amount, if any, that is to be recorded in the 2003 Operations & Maintenance Expense Deferral Account ("2003 O&MDA") described below, the parties agree that the Company's overall O&M expense budget for the Test Year will be $270 million plus the amounts included in the DSM O&M budget described under Issue 9.1. The parties agree that the O&M expense allowance of $270 million is an "envelope" amount that the Company can allocate as it wishes.

161

> An unresolved issue between the Company and intervenors pertaining to the amount of O&M expenses for 2003 to be recovered from ratepayers is the amount, if any, by which the total O&M expenses envelope of $270 million is to be reduced to reflect the efficiency gains which intervenors say were transferred by Enbridge Gas Distribution to affiliates and then, in part, to a related party, between October 1, 1999 and September 30, 2002, being the term of the Board approved targeted performance based regulation ("TPBR") plan. The Company does not agree that the alleged efficiency gain transfers during the term of the TPBR plan are an appropriate matter to be considered by the Board in the determination of its O&M expenses to be recovered from ratepayers in the Test Year and thereafter. However, the Company does agree that if the Board does accept the intervenors' position with respect to this issue then any financial impact of the Board's determination for the Test Year is to be recorded in the 2003 O&MDA. Any amounts recorded in the 2003 O&MDA as a result of the Board's decision in this case will be credited to ratepayers at a time and in a manner to be determined by the Board. Further details pertaining to the creation of the 2003 O&MDA and the accounting methodology applicable thereto are described under Issue 10.2.

162

> Intervenors take the position that if the issue pertaining to a deduction of transferred efficiency gains is resolved in favour of intervenors, then the Board deter-

mined deduction amount is to be considered in a determination of the Company's overall O&M expenses allowance in the 2004 Test Year.

163

All parties acknowledge that the agreed upon O&M expense envelope of $270 million covers all of the expense line items in which corporate costs allocated by Enbridge Inc. to Enbridge Gas Distribution are recorded. Accordingly, for the Test Year the cost consequences of Enbridge Inc.'s corporate cost allocations to Enbridge Gas Distribution have been settled on condition that policy issues pertaining to Enbridge Inc. corporate cost allocations to Enbridge Gas Distribution and its Intercorporate Services Agreement with Enbridge Gas Distribution remain unresolved and are to be determined in accordance with the provisions of this Settlement Proposal specified under Issue 7.43, proposed Issue 7.45, and Issue 8.1.

164

The intervenors have agreed to establish the 2003 O&MDA because neither the Company's affiliates nor the related party have provided the information that intervenors say is a prerequisite to a determination of the value of the alleged efficiency gain transfers. The Company believes that it has provided sufficient evidence for the Board to establish just and reasonable rates for the Test Year. Intervenors will be seeking rulings from the Board compelling production and disclosure of the requisite information from the affiliates and the related party which realized the alleged efficiency gains during the term of the TPBR, being EI, ECS, CWLP, EGS and EOS.

165

The Settlement of the O&M expense "envelope" and unresolved policy issues in the manner described herein is intended to facilitate the earliest possible implementation of rates.

166

The Board was asked to decide whether there should be an amount included in the O&MDA to reflect the efficiency gains as described in issue 7.1 of the Settlement Proposal and if so, how much.

167

Two approaches were presented to guide the Board in this question. Intervenors focussed on an examination of the costs and revenues of the outsourced service providers and the utility in an effort to both determine where efficiencies may have been realized and to quantify those efficiency gains. The Company’s approach was to examine the reasonableness of the fees being charged by the outsourced service providers. The Company’s view was that the fees are reasonable and they have produced evidence to support this view.

168

Intervenors submitted that ratepayers should benefit from sustainable O&M expense reductions garnered during the TPBR plan period, while the Company argued that the benefit to the ratepayer accrues as a lower Cost-of-service at the point of rebasing.

169

The Board is aware that there are many service providers that have contracted with the Company, and that some of these relationships have been in existence for decades. However, the Board will

focus only on the outsourced functions being provided by the affiliated companies EI, ECSI, CWLP, EGS and EOS because these entities were the subject of issue 7.1 in the Settlement Proposal.

170

To assist in its assessment of the above questions, the Board has organized the positions of the parties into subject areas in an effort to impose a structure on the various sub-issues that make up this chapter. The sub-issues are benchmarking, *Affiliate Relationships Code for Gas Distributors* ("ARC" or "Affiliate Relationships Code"), benefits to ratepayers of outsourcing, customer care, contract terms, efficiency gains and TPBR, O&MDA and other submissions. Certain parties' positions may appear under more than one heading because the sub-issues have a degree of "cross-over". The Board has considered all of the issues in its findings. The positions of the parties are set out as follows.

171

2.3 Benchmarking and Other Cost Comparisons

The Company's Position

172

The Company said that one of its longstanding "macro" measures to evaluate O&M expenses is cost per customer and that both the Company and the Board have relied on this measure in the past to review cost levels and trends over time.

173

The Company sponsored a study by the Pacific Economics Group ("PEG Study"). The PEG Study, filed in this proceeding, evaluated the O&M cost performance of EGDI. The report showed that based on the Company's original applied-for O&M budget, the Company would rank 43% above the mean for all gas-only utilities and 33% above the mean for large gas-only utilities, a first place rank. The report concluded that the productivity implicit in this budget "can be achieved on a sustained basis only with superior cost management".

174

The author of the PEG Study, Dr. Lowry, testified that after receiving information about the lower Settlement Proposal level of O&M, and having the benefit of additional time, he applied even more sophisticated econometric modelling to his analysis of the Company's O&M costs. His conclusion was that the Company's productivity was up to 40% above a standard that included a large number of American companies and B.C. Gas.

175

The Company acknowledged that benchmarking does not provide a complete evaluation of its O&M performance, especially given the fact that benchmarking cannot measure some qualitative aspects of its performance. However, both the Company and Dr. Lowry said that they believed that benchmarking is a useful way to measure the Company's quantitative performance.

176

In 1999, the Company engaged Computer Sciences Corporation ("CSC") to assess its customer care costs. CSC concluded that the Company's costs were reasonable and that ratepayers were being fairly charged for customer care services. The CSC report was filed in RP-1999-0001, EGDI's fiscal 2000 rates case.

177

In 2000, the Company engaged E-Source to conduct an anonymous tender for the entire customer care package. E-Source issued its final report in April 2001. The conclusion reached by E-Source was that there were two vendors poised to compete for the EGDI customer care package and that the tendered costs obtained were similar to those under the Company's service agreements with ECSI that were in effect at the time. The Company's submission is that the results of this tender are important for two reasons:

178

- First, they confirmed the reasonableness of amounts that EGDI was paying at the time to ECSI for customer care services; and

179

- Second, they formed part of the Company's determination of the fair market value of customer care services before the Company signed the contract with CWLP on January 1, 2002.

180

In 2000, the Company also engaged MICON Consulting Inc. ("MICON") to conduct an independent assessment of the Company's CIS solution and the associated outsourcing agreement with ECSI. MICON compared both service level targets and per customer charges to other similar service agreement bids recently received for another MICON client representative of a large scale utility distribution company. MICON concluded that the Company's outsourcing agreement with ECSI (now with CWLP) was consistent with the service agreement bids as far as service level targets were concerned and was highly competitive in terms of the cost per customer charge.

181

In addition to the benchmarking work undertaken by CSC, MICON and E-Source, the Company said that it also undertook the following steps to validate the prices that it pays for customer care services:

182

(1) participated in the EEI/AGA survey that reviews the operating costs of 70 to 80 utilities across North America;

183

(2) participated in a more focussed survey that is conducted by the PA Consulting Group;

184

(3) subscribed to and analysed information assembled by TECC Group Inc. summarizing O&M costs reported by American utilities to FERC;

185

(4) compared its contract to the contract signed by B.C. Gas; and

186

(5) engaged Mr. Louth, who used information from two proprietary databases, information from his own database of sources in Canada and the United States, and information about B.C. Gas customer care costs in his determination that EGDI's customer care costs for 2003 are reasonable.

187

2.4 Positions of the Intervenors - Benchmarking and Other Cost Comparisons

188

CAC's witness, Dr. Bauer, addressed benchmarking and observed, as follows:

189

> To be meaningful, benchmarks need to reflect structural best operating practices and not a one-time comparison with another utility or group of utilities. The fundamental problem of utility markets - that they are not effectively competitive - cannot be overcome by the use of benchmarks.

190

CAC and other intervenors asserted that none of the affiliate outsourcing arrangements were the subject of a tender in a competitive market and this led to their conclusion that the reasonableness of the pricing arrangements cannot be assessed by market data.

191

CAC observed that Dr. Bauer was asked whether the Board should rely on the evidence of Dr. Lowry and Mr. Louth in determining whether or not the prices charged in the affiliate transactions represented either fair market value or a market-based price. Dr. Bauer's response was that "it is one consideration, but it's insufficient to make this determination". Dr. Bauer further observed that "benchmarking cannot be used to establish a proxy for a market price, and the reason - the reasons I gave are threefold: one is that we really do not observe competitive market prices. These are, as far as we see at this point, common negotiated prices, prices that are not determined in an open market. Secondly, that, you know, other factors that influence the level of those charges are not being considered. And last but not least, that even if you - even if you were to solve all these issues, we couldn't really determine what the relevant benchmark is".

192

Dr. Bauer was also asked whether the ARC would allow the use of benchmarking to establish prices. His response was "it doesn't explicitly exclude it, but I think the problems with benchmarking that I identified would, in my view, suggest that benchmarking is not an instrument to achieve that goal".

193

IGUA stated that the insurmountable problem EGDI faces is that a price supported by benchmarking evidence is not a market price. The outsourcing arrangements made during the TPBR plan period were not the result of a fair and open competitive bidding process, and as a result they do not reflect market prices.

194

Schools and IGUA presented the view that EGDI has substituted after-the-fact rationalizations for hard evidence of market pricing of the amounts it is paying ECSI and CWLP.

195

Schools said that EGDI's efforts to obtain a surrogate for market value are not compelling. They included a "shadow tender" to which only one of 12 recipients of the original information package submitted a serious bid, and a confirmation by Mr. Louth that the costs per customer paid by EGDI to CWLP are $5.25 higher than the fees paid to CWLP by B.C. Gas, a comparable utility.

196

Schools criticized Mr. Louth's sample for benchmarking. The sample consisted of only 18 unnamed utilities and the large majority of them are apparently US companies, comparisons to which Mr. Louth stated in his main report could be misleading. Notwithstanding Mr. Louth's comment that most of the utilities "operated in an environment that is deregulated to some degree", he removed from EGDI's costs, costs relating to direct purchase customers. Schools recalled that half of EGDI's mass market is direct purchase, so these costs presumably represent a substantial proportion of EGDI's costs.

197

Schools said that only 10 of the 18 utilities had outsourced "all or part" of their customer care services. Finally, the 18 were asked, often by telephone interview, to eliminate "one time" and "extraordinary charges" from their 2003 budget. In Schools view, this was not a satisfactory basis for the analysis.

198

Schools argued that the other survey materials relied upon by EGDI were no more persuasive than Mr. Louth's evidence. All four of the analyses, PA Consulting Services, TECC Services Inc, AGA and E-Source Financial Times Energy Inc., were deficient in various respects:

199

- most were dated, showing data for 1999, 2000, or 2001;

200

- it was not clear what costs (i.e. direct purchase related costs ancillary services) had been removed;

201

- the reporting was inconsistent;

202

- only 12 of the 33 in the PA survey outsourced their customer care; the remainder did it in house. It was not disclosed to what extent competitive tendering was used;

203

- the comparison between EGDI's costs and the average costs of the surveyed utilities, which are virtually all American, were done using an exchange rate of 1.5 and without a purchasing power parity ("PPP") factor option;

204

- two of the surveys PA and E-Source included both gas and electricity utilities; and

205

- two of the four surveys AGA, and E-Source used utilities of all sizes, when scale is obviously a factor in such comparisons.

206

Schools asserted that EGDI's survey evidence did not change the basic conclusion that EGDI's payments to ECSI, CWLP and CWLP/Accenture, are not based on market values for the services.

207

School Boards submitted that there are three reasons why benchmarking has limited usefulness.

208

1. It is difficult to get a true apples to apples comparison between utilities that would make benchmarking data compelling evidence.

209

2. The obligation of a public utility franchise holder is not to be as good as, or better than, the industry average. It is, rather, to keep costs and therefore rates as low as reasonably possible.

210

3. It is not necessary to have benchmarking evidence in order to have confidence in the Company's management.

211

School Boards submitted that the primary value of benchmarking information is not in justifying the utility's actions, expenditures, and programs, but rather in acting as an indicator that costs may be out of line.

212

VECC argued that the benchmarking studies do not establish a market price or fair market value for the customer care service package. At best, they demonstrate that EGDI is paying slightly above the average cost per customer of the two largest utilities in the north-eastern US.

213

VECC maintained that its analysis showed that EGDI is paying too much for customer care services and that the B.C. Gas price is at best a generous comparison for EGDI.

214

VECC pointed to a further difference in cost between EGDI and B.C. Gas Utility in the CIS service cost. EGDI is paying $11.62 per customer per year for the ECSI hosted CIS ($18.3 million in 2003). B.C. Gas Utility transferred its Project Mercury Assets to CWLP at a price approved by the British Columbia Utilities Commission (“BCUC”) and now pays $8.42 per customer per year for CIS services.

215

VECC submitted that EGDI has not justified its CIS fee as reasonable. The studies by CSC, MICON and E-Source do not establish either the fair market value of the CIS asset or the associated CIS service cost.

216

VECC and other intervenors asserted that EGDI was avoiding potential regulatory cost disallowance by transferring the CIS asset outside the utility, then charging EGDI back for the services that it was designed to provide.

217

VECC submitted that it would not be appropriate for the Board to request new evidence on a cost-based price at this stage of the proceedings. VECC said that as part of its next regulatory filing EGDI and its affiliates/related parties should provide proper evidence on a cost-based price in accordance with section 2.3.3 of the ARC.

218

VECC said that the record shows that EGDI is paying too much for customer care services by virtue of the returns made by ECSI/CWLP acting as a middleman between EGDI and Accenture.

219

VECC stated that the comparison with B.C. Gas demonstrates that EGDI is paying significantly more (about $5 per customer per year or about $8 million a year) for a comparable package of customer care services. The comparison presented by EGDI and Mr. Louth does not adequately reflect the much larger customer base and transaction volume of EGDI.

220

VECC cautioned that the 30% ownership of B.C. Gas in CWLP raises a presumption of preferential treatment of the service provider that places a high onus of proof that the price being paid was market driven. In this regard, the fact that the BCUC has approved the fees B.C. Gas Utility pays to CWLP is an indicator but not absolute evidence of fair market value.

221

2.5 The Company’s Reply - Benchmarking and Other Cost Comparisons

222

The Company acknowledged that while benchmarking does not provide a definitive evaluation of O&M performance, it is a useful tool in measuring the Company's quantitative performance.

223

The Company said that it retained Dr. Lowry because the reasonableness of the Company's proposed non-gas O&M expenses was an issue in this proceeding. Dr. Lowry’s research addressed the cost efficiency of EGDI in managing its gas distribution O&M. The Company pointed out that there is, obviously, no competitive market price available for a gas distribution utility's entire O&M budget.

224

The Company submitted that unlike a utility's entire O&M budget, customer care costs can be compared or benchmarked to competitive market information and, indeed, to competitive market prices. The cost comparisons performed by Mr. Louth related to customer care services and in his report he points out that, among other things, he benchmarked the Company's customer care costs against 18 gas and electric utilities evenly distributed across North America and that 10 of the companies in the sample had outsourced all or part of their customer care services to an "arms-length provider".

225

The Company did not believe that Dr. Bauer's evidence detracted significantly from the Company's position on benchmarking. The Company argued that CAC failed to distinguish how the evidence of Dr. Bauer applies to the different types of benchmarking or cost comparisons.

226

The Company agreed with the parties that there are competitive market prices for customer care services. However, the Company maintained that it pays market prices for such services and that the evidence supports this. The Company argued that even if competitive market prices were not available, Dr. Bauer's evidence is that the options are to benchmark or to arrive at a reasonable fair market value through an assessment of the service provider's costs and the risk situation of firms in that business. The Company noted that neither the intervenors who sponsored Dr. Bauer's evidence, nor any other intervenors, introduced or elicited evidence to indicate that the prices paid to the customer care service provider exceed a reasonable fair market value. The Company stated that, on Dr. Bauer's evidence, the other available option is benchmarking.

227

The Company responded to the criticism that some of the benchmarking work was completed after the implementation of the original outsourcing of the customer care functions to ECSI:

228

- the Company participated in the AGA survey for a number of years prior to 1999;

229

- CSC Planmetrics reviewed the Company's customer care costs in connection with CIS charges prior to the RP-1999-0001 proceeding in 1999;

230

- the TECC survey results go back to 1996; and,

231

- the Union Gas / Enlogix arrangement dates to 1998.

232

The Company submitted that Schools had failed to provide reasons why the timing of the Company's benchmarking work should invalidate it. The Company said that it is important to bear in mind that these studies take a great deal of time and effort to carry out and compile.

233

The Company reiterated that at the time when the customer care functions were transferred to ECSI, the utility's internal fully allocated costs were considered as a benchmark that helped to confirm the findings of these analyses. The Company also had additional information on market prices for billing services and call center costs from articles and work carried out by ESI.

234

The Company objected to Schools disputing the Company's analysis of B.C. Gas' customer care cost, without acknowledging that this is a head to head comparison where the similarities and differences are well known and can be adjusted for.

235

The Company submitted that the Board can and should attach value to the benchmarking evidence in its determination of the reasonableness of customer care costs.

236

The Company reiterated that in 2000, it engaged E-Source to conduct a tender for the entire customer care package. The tender results showed two vendors poised to compete for the Company's customer care package and that the tendered costs were similar to those under the Company's service agreements with ECSI. The results of this tender were available to the Company in its determination of fair market value before signing the contract with CWLP on January 1, 2002.

237

The Company noted that with the exception of Schools, no intervenors raised any issues or concerns in argument about whether the E-Source tender call constituted a "valid tendering process" for the purposes of section 2.3.2 of the ARC. The Company said that intervenors who argue, or suggest, that the Company offered "only benchmarking evidence" are simply not correct.

238

The Company submitted that pursuant to the second sentence of section 2.3.2 of the ARC, the results of the E-Source tender does provide evidence of fair market value meeting the requirement of the first sentence of the section.

239

The Company said that it continually monitors and analyses market prices for customer care services because it has a right to reopen its contract with CWLP if it can show that a better price is avail-

able in the marketplace. If there is any evidence that the prices paid for any of the components of customer service are above market prices, the Company can take that evidence to CWLP under the reopening provision of the contract.

240

The Company argued that it is through fair market pricing that the Company and its ratepayers benefit from efficiencies achieved by service providers. As far as affiliate service providers are concerned, this is confirmed by the ARC, which lays out the rules for affiliate transactions. Where a “fair market value” is available for a service, the ARC provides that purchases from affiliates will be evaluated on a “fair market value” standard. It does not provide for such purchases to be assessed in relation to the service provider's efficiencies. Dr. Bauer ended up at the same result when, in relation to tracking of affiliate efficiency gains at the end of PBR, he said that the Board should either "benchmark" or "come to an assessment of what a reasonable, fair-market value would be".

241

The Company noted VECC’s challenge of the Company's benchmarking of its customer care costs to those of B.C. Gas:

242

1. that the environmental differences between the companies should not impact customer care costs;

243

2. that EGDI's large size should dictate lower charges; and

244

3. that on an individual service by service basis some of the Company's prices were higher than those of B.C. Gas.

245

The Company stated that its comparison of its customer care costs to those of B.C. Gas was designed to result in an "apples to apples" test to the greatest extent possible. EGDI's fees per customer were adjusted to reflect the same package of services that B.C. Gas purchases from CWLP. Obvious factors that would be expected to drive differences in customer care workload between the companies were identified. Mr. Louth confirmed that, given the size of these two companies, scale differences would be of little consequence in terms of price determination. Furthermore, the Company's evidence explains that the only documented B.C. Gas CWLP charge is the total annual fee per customer, making service to service price comparisons impractical.

246

2.6 Affiliate Relationships Code

The Company’s Position

247

The Company submitted that it has structured its outsourcing arrangements with affiliates in accordance with the rules established by the Board in the ARC. In general, the Company said it was guided by section 1.1 of the ARC, which states that the "principal objective" of the ARC is to enhance a competitive market "while saving ratepayers harmless" from the actions of gas distributors, transmitters and storage companies with respect to dealings with their affiliates. In particular, the Company said it was guided by the transfer pricing provisions found in section 2.3 of the ARC.

248

2.7 Positions of the Intervenors - Affiliate Relationships Code

249

CAC’s witness, Dr. Bauer, observed that to try to assess the reasonableness of the prices charged under outsourcing arrangements with affiliates, the ARC may not be helpful. He stated:

250

> If a utility is part of a larger holding company, management's incentives are altered. Under costs of service regulation, there is a well-known incentive to increase transactions with (unregulated) affiliates and to price such transactions to shift profits to the affiliate and costs to the utility. The provisions of the ARC regarding transfer pricing were adopted to keep such undesirable behaviour at bay.

251

> However, whether the spirit of the ARC can be effectively implemented depends to a considerable extent on the ability of the Board to evaluate internal transfer prices for services between affiliates against an independent reference point.

252

Dr. Bauer suggested that the principal way to deal with the concern he has described "would be to conduct a thorough cost review of the outsourcing transaction". He then observed, however, that this would not be a problem "if reference prices determined in an effectively competitive market could be observed". He stated, however, that "if such market prices do not exist, for example, because the service markets are not effectively competitive or do not exist at all, outsourcing poses a dilemma for the regulator. A substantive cost review would require detailed information on the costs of the third party service provider".

253

Dr. Bauer further observed that "unless reliable information from an effectively competitive market is available, information from the affiliates is required to evaluate the experience with PBR. To determine whether a price paid to an affiliate reflects a fair market value, it is necessary to examine the return on investment achieved by the affiliate in transactions with the utility".

254

IGUA disagreed with EGDI's assertion that there is any uncertainty about the question of whether the "no harm to ratepayer" test applies to an evaluation of the arrangements that EI and EGDI put in place with the newly created affiliates during the term of the TPBR plan. IGUA said that the Board's RP-2001-0032 decision has clearly decided that the "no harm to ratepayer" test is inapplicable. [RP 2001-0032 Decision, para. 5.11.18]

255

IGUA argued that no stand alone utility, acting prudently, would incur the expense of restructuring its resources in affiliates where the total costs incurred to restructure resources and to acquire them from the same people who provided them previously are the same as or greater than the costs incurred before restructuring. As Dr. Bauer testified:

256

> "A rational cost minimizing firm would outsource if the total costs of outsourcing were less than the total cost of producing a service in house."

257

IGUA submitted that EGDI chose to ignore common sense and rely on the "no harm to ratepayer" test in order to attempt to justify its use of fully allocated avoided costs as a guide to the pricing of its arrangements with the newly created affiliates. IGUA submitted that this underscores the fact that the primary driver for the arrangements was the objective of permanently enhancing EI's returns at the expense of ratepayers.

258

IGUA argued that since EGDI did not use third party service provider costs to determine the pricing of its arrangements with affiliates providing customer care nor to guide the pricing of its arrangements with EOS and EGS, it is incorrect for EGDI to assert that it structured its outsourcing arrangements with affiliates in accordance with the rules established by the Board in the ARC.

259

IGUA and CAC submitted that the provisions of the ARC do not assist EGDI in its attempt to avoid accounting for the TPBR plan end-of-term O&M cost reductions.

260

Schools and other intervenors said that the fact that EGDI did not tender the outsourcing of the customer care services and thereby test the pricing of the services acquired from the affiliate against the market, means unless EGDI can demonstrate market value in some other way, it is not in compliance with ARC. A number of intervenors asserted that, having not tendered, EGDI has no first hand, hard reliable evidence of market value or market based prices.

261

VECC submitted that when corporate strategy directs outsourcing to one or more affiliates of the utility without tender, then the onus is high to demonstrate that all aspects of the ARC, especially the transfer pricing provisions, are fully complied with.

262

VECC asserted that even though EGDI claims that CWLP is not legally an "affiliate", the standard and onus of the ARC in terms of transfer pricing are the same by virtue of the untendered nature of the arrangements.

263

VECC asserted that EGDI has not provided evidence of a cost-based price as required by the ARC where a market based price is not available. It could have used the evidence on the service provider's costs to offer a cost-based price for customer care services on a going forward basis, but has chosen to rely on its benchmarking evidence instead.

264

VECC submitted that absent any proper evidence of a market price or fair market value, the use of a cost-based price based on the service providers' costs without profit, but including an allowance for capital, best conforms to the pricing provisions of Section 2.3.3 of the ARC. VECC urges the Board to adopt this pricing method in making its determination of a fair market value for EGDI's customer care Services from ECSI/CWLP/Accenture.

265

2.8 The Company’s Reply - Affiliate Relationships Code

266

The Company disagreed with VECC's interpretation of the ARC. The ARC does not say that the only way to establish fair market value for services purchased from an affiliate is by means of a

tender. The Company also said that intervenors are wrong when they say, or imply, that the Company offered only benchmarking evidence with respect to customer care costs.

267

The Company contended that it is important that any discussion of this issue begin with the actual words of the applicable transfer pricing provisions of the ARC. Transfer pricing for the purchase of a service, resource or product by a utility from an affiliate is dealt with in sections 2.3.2 and 2.3.3 of the ARC. The words of section 2.3.2 of the ARC are as follows:

268

> In purchasing a service, resource or product, from an affiliate, a utility shall pay no more than the fair market value. For the purpose of purchasing a service, resource or product a valid tendering process shall be evidence of fair market value.

269

The Company pointed out that the reference point established by section 2.3.2 is "fair market value" (as opposed to, for example, a market "price"). While a tendering process may be effective to identify the lowest possible price, it is not necessarily effective, on its own, to identify value. If, for example, a "lowball" price is received in response to a tender call, it is likely that judgment will have to be applied in an effort to determine whether that price really represents good value (and to assess the risks that flow from acceptance of a lowball bid).

270

The Company further pointed out that the second sentence of section 2.3.2 says that a valid tendering process "shall be" evidence of fair market value. What this means is that, if the utility provides evidence of fair market value based on a valid tendering process, this will be acceptable evidence of fair market value. The second sentence of section 2.3.2 does not say that a valid tendering process "shall be the only acceptable evidence of fair market value". A valid tendering process is an acceptable way, but not the only acceptable way, of proving fair market value.

271

2.9 Benefits to Ratepayers of Outsourcing

The Company's Position

272

The Company claimed that there are many benefits to ratepayers from the outsourcing arrangements. Citing gas control as an example, the Company said that the transfer of the gas control functions to EOS in Edmonton has provided benefits to the utility that, although difficult to quantify, are nonetheless significant for the following reasons:

273

- When gas control functions were performed in Toronto, it was always difficult to maintain a full complement of controllers.

274

- Edmonton has a large pool of experienced pipeline controllers, who were familiar with shift work. Now there are 70 controllers in the facility in Edmonton and the time and expense of training new controllers has been significantly reduced.

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- The services from gas control in Edmonton are superior to those that were provided in Toronto.

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EGDI pointed out that in terms of pricing the gas control services, no market pricing benchmarks for the services provided by EOS were available at the time when the utility entered into outsourcing arrangements for gas control services. Furthermore, EGDI noted that EOS did not start with a functionality that would allow a determination of its costs. EGDI consequently determined that, at the outset, the cost of providing the services were best estimated by reviewing the utility's historical costs of providing the services. The fees for services performed by EOS were therefore based on the Company's fully allocated costs of performing the services. EOS has provided services to EGDI during two full fiscal years, 2001 and 2002.

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The Company also advanced the following reasons for establishing its gas supply services in Calgary:

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- The hub of activity for gas supply services is in Calgary. The advantage of Alberta over Ontario is that it offers better access to markets, resources, knowledge and people who are "well-networked" in this part of the gas industry.

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- The Calgary location should result in better prices for gas than could be achieved in Ontario.

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- The Calgary location was seen as a way of meeting the challenge of the transactional services target.

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During his testimony, Company witness Mr. Frank Brennan explained how the advantages of the outsourcing to EGS have resulted in financial benefits for ratepayers. He provided two examples of these financial benefits, totalling $2.6 million, in the context of EGS managing gas shipments on the TransCanada Pipelines system and the Alliance pipeline.

282

As in the case of operational services, EGDI maintained that in terms of pricing the services, the market pricing benchmarks for the services now provided by EGS were not available at the time when EGDI first outsourced these services and the service provider had not yet achieved a functionality that would allow a determination of its costs. Therefore, the fees for the services now provided by EGS were based on the Company's fully allocated costs of performing such services. The appointment of EGS as the Company's agent to provide gas supply services was effective on October 1, 2002.

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2.10 Positions of the Intervenors - Benefits to Ratepayers of Outsourcing

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Energy Probe agreed with EGDI that some benefits did accrue to ratepayers as a result of the TPBR plan.

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Energy Probe pointed out that shareholders benefited during the first two years of the TPBR plan and, in accordance with the original TPBR design adopted by the Board, Energy Probe's view was that these benefits should not be clawed back for ratepayers. The TPBR plan was intended to encourage efficiencies for the benefit of shareholders and ratepayers.

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Energy Probe emphasized that it does not take the view that all shareholder benefits obtained through PBR should be extracted for the benefit of ratepayers. Ratepayers only have a legitimate claim on the sustainable benefits achieved at the conclusion of the PBR period, not those achieved prior to the last year.

287

Schools argued that the savings must be repatriated to the utility in order to meet the Board's test, articulated in the RP-2001-0032 Decision that the utility must clearly demonstrate that the outsourcing transaction will result in benefits to ratepayers.

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Schools and IGUA submitted that the only way that the ratepayer can benefit financially from the reallocation of the customer care function to ECSI is if it can be demonstrated that the customer care services had been provided at a lower cost to the ratepayers than would have been the case had the function remained within the utility.

289

Schools said that the savings should be repatriated from the affiliates because EGDI and Enbridge Inc. failed to disclose to the Board or the intervenors its intention to engage in a massive reallocation of utility functions to its affiliates at any time during the RP-1999-0001 proceeding, even though the planning for reorganization of the utility was well underway by mid-1999, and was virtually complete by the time of the hearing in the fall of 1999.

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2.11 Customer Care

The Company's Position

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At the time of the transfer of the energy services businesses to Enbridge Services Inc., the Company explained that it made an unsuccessful attempt to separate the call center for the regulated utility from the call center for the unregulated businesses. The separation of call centers proved to be less efficient than the combined call center leading to a decline in service levels.

292

The Company noted that, at this time, Ontario was one of the most advanced jurisdictions in North America when it came to retail gas sales to residential customers and that this situation fostered a tremendous workload for the customer care part of the business. Calls received in the call center related not only to the regulated gas distribution business; calls were being received about marketers, conservation and about all aspects of the deregulated marketplace. At the same time, customers were confused about the opening of the gas market to retail competition and, in the initial stages, up to 20,000 calls per day were being received in the call center.

293

The Company explained that its Customer Information System ("CIS") was also a factor that it considered in its decision to outsource customer care. ECSI was created to provide CIS service to the

utility and potentially to the businesses that eventually became ESI. The concept evolved to the point where the Company concluded that it would be beneficial for both the shareholder and customers to expand the role of ECSI so that it could provide customer care for the utility, for the unregulated energy services businesses and for other companies.

294

EGDI asserted that while earning money for investors was important to EGDI, it was not the most important consideration. Former EGDI President Mr. Rudy Riedl testified that he reported to the shareholders regularly at meetings, but he was hearing from customers every day. He emphasized that the outsourcing of customer care was an action driven by necessity, the desire to maintain service levels and control costs, and the need to work in the new market environment; it was not a devious plan to "hide things". In his testimony, Mr. Riedl referred to this solution as an "imperative".

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The outsourcing proposal was taken to, and approved by, the EGDI board of directors on November 9, 1999. Management reported to the EGDI board of directors about the business separation in February, 2000.

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The Company explained that another aspect of the outsourcing decision was that the rental program had well over one million customers at the time when it was unbundled which placed the Company at risk of losing economies of scope and scale. A decision to proceed with two call centers, two billing systems and two billing administration groups would not be an efficient solution. The creation of ECSI enabled the Company to retain economies of scale that would otherwise have been lost through the unbundling of the retail businesses to ESI.

297

The Company identified three main monetary benefits associated with the outsourcing of customer care functions. First, the fees paid for customer care services provide a benefit to ratepayers through competitive market pricing. Second, there is a reduced management cost associated with administration of a group of employees, now outsourced, numbering in the order of 1,100. The third monetary benefit is the reduced need for facilities, which flows back to ratepayers either through elimination of rate base or through revenues from service providers using the Company's facilities that are credited to the cost-of-service.

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EGDI commented that the total cost of the outsourced customer care functions as of October 1, 2002 was less than at October 1, 1999.

299

EGDI calculated that over the life of the CIS Service Agreement, ratepayers will benefit by more than $30 million, when outsourced CIS service charges are compared to the effect of closing the capital cost of the CIS system to rate base and recovering that cost in the form of depreciation, return and tax.

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EGDI argued that an important non-monetary benefit is the reduction of risk for the utility and its ratepayers, particularly in the area of information technology. The Company purchases customer care services, not systems, and the risk of changing technology is borne by the service provider. Also, the effect of the outsourcing is to mitigate risks associated with potential stranded costs, particularly in relation to the impact of vendor consolidated billing as contemplated by the current version of the Gas Distribution Access Rule ("GDAR"). If gas marketers do take on the role of billing

for gas distribution charges, the Company stands to benefit under its service agreements with CWLP to the extent that it can avoid the cost of producing a bill and of answering billing enquiries. Conversely, if the Company still performed customer care functions internally, the current version of GDAR would raise issues of employee lay-offs and stranded assets.

301

According to the Company, another aspect of reduced risk is that the Cost-of-services is fixed, by means of approximately 30 different unit prices that are specified in the services agreement with CWLP. Because these unit prices are fixed, the service provider assumes the risk of cost escalations, while at the same time, the utility has an ability to manage its costs by taking steps to minimize the quantity of different services in respect of which the service provider charges a unit price. In other words, because the contract is transaction-based, the Company can minimize costs to the extent that it can manage its business in a way that minimizes the number of transactions. For example, the Company puts considerable effort into educating customers so that calls to the call centre are cut down.

302

The Company said that the outsourcing arrangements provide it with access to experience and expertise that would not be available internally. The Company now deals with Accenture, which provides similar services across the world and which has expertise that the Company would never be able to develop as a stand alone internal service provider.

303

With respect to the costs for the customer care service, EGDI indicated that when customer care services were first outsourced to ECSI, it relied to the greatest extent possible on market prices, although in some cases, where a direct market comparator could not be found, the utility's costs were used. Because the people and the assets transferred to ECSI came from the utility, management of the utility knew the costs of providing particular customer care services.

304

The way that the gas distribution utility shares in customer care service provider efficiencies is through market pricing. The Company said that it is paying market prices for customer care services and, if, during the term of the contract, there is ever any evidence that the Company is paying anything more than a market price, it has the right to reopen the contract.

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2.12 Positions of the Intervenors - Customer Care

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IGUA disputed the suggestion that the decision by EI and EGDI to create a customer care affiliate was primarily caused by external events beyond their control.

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IGUA’s view is that the evidence indicates that by June of 1999, the primary driver for the creation of a customer care affiliate using utility resources was to deprive ratepayers of the end-of-term TPBR rebasing benefit. The additional motive for creating a customer care service provider was to avoid further OEB scrutiny of CIS capital and operating costs.

308

IGUA also disagreed with the Company’s assertion that Government and regulatory policy favouring the separation of competitive businesses from monopoly utility operations caused EI and EGDI

to create unregulated affiliate service providers to continue to perform utility functions for EGDI. IGUA stated that this a business strategy which falls outside the ambit of the "pure utility" policy.

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IGUA and CAC urged the Board to find that EI and EGDI have not responded to the Board's approved TPBR plan in a manner consistent with the plan's spirit, intent and objectives.

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Schools suggested that the shift in responsibility for the customer care function, which depends on the CIS system, to ECSI, was in part a decision of EI and EGDI to reduce the exposure of stranding CIS assets. This is reflected in the evidence of the Company witnesses, Mr. Letwin and Mr. Riedl. Rather than reapply in the subsequent year, even though the CIS system was fully operational by the early fall of 2000, EI decided to transfer the CIS assets out to ECSI, in part to minimize further regulatory scrutiny.

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Schools further noted that the extent to which the customer care outsourcing was done to clear up a mess created by an improperly executed unbundling of utility functions cannot be a reason to avoid compensating EGDI ratepayers for lost savings.

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Schools submitted that the "new business" created by transferring the core of 1,100 trained and experienced employees from the utility to ECSI would be able to attract other clients in need of customer care services. There were similar expectations with respect to EOS and EGS. Notwithstanding this objective of leveraging the utility's expertise, the Enbridge affiliate did not pay anything to the utility for the transfer of these employees.

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Schools suggested that in determining the amounts actually paid to the affiliates for customer care service, the most critical contract from EGDI's perspective was the initial contract between EGDI and ECSI, effective January 1, 2000, since it set the pattern for what followed.

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2.13 Contract Terms
The Company's Position

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The Company noted that the agreement with CWLP contains provisions that allow EGDI to renegotiate components of the price if it can bring forward evidence that a specific component is available at a better price with a comparable level of quality. Specifically, the agreement allows EGDI to initiate a "scope change" in the event of material changes to pricing "in the marketplace" or industry standards for services substantially similar to the services provided under the agreement. Because of this entitlement to reopen the contract based on pricing in the marketplace, EGDI continually monitors and analyses market prices for customer care services.

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2.14 Positions of the Intervenors - Contract Terms

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CME had concerns with the terms of the customer care outsourcing contract. Section 11.3 (b) of the CWLP Client Services Agreement ("CSA") provides that prior to the end of the initial term or additional terms, EGDI may solicit third parties to provide one or more of the services covered by the

CSA by issuing a Request for Quotation. CustomerWorks has the option of matching any such quotation and obtaining the renewal of the CSA with respect to those services.

318

CME observed that Section 11.3 (b) was described by Mr. Louth as "a weakness in the contract". CME said that Mr. Louth warned that it may be very difficult for the utility to secure competitive bids on this basis. CME submitted that in order to avoid seeking the quotations in bad faith, EGDI should disclose the CustomerWorks renewal option to third parties in any Request for Quotation.

319

CME also submitted that subsequent to January 1, 2002, EGDI had the opportunity to amend the CSA by deleting Section 11.3(b) when EGDI was required to give its consent to the purchase of the CSA by Accenture. Mr. Louth commented upon this missed opportunity. "We consider that an opportunity to amend the CSA might have been lost when Accenture and CWLP were discussing the new arrangements. We believe both B.C. Gas and EGDI were possibly in a position at that point to negotiate more favourable terms with CWLP, but neither did so."

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CME submitted that the Board should remedy this omission or oversight by requiring EGDI to amend the CSA by deleting Section 11.3 (b).

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IGUA stated that whatever EGDI has "locked in" as a result of its contracts with service providers ought to have no influence on the manner in which the Board decides the issues in this case.

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Schools expressed considerable concern that the contractual arrangements surrounding the customer care arrangements will not incent Enbridge Inc. to allow EGDI to bargain on contract renewal for fee reductions, nor will EGDI be allowed to aggressively bargain during the first contract term, since any reduction in payments will result in lower profits to CWLP, and hence to EI, and may cause CWLP to have to indemnify Accenture.

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Schools submitted that while EI's investment risk may not be zero, it is minimal as a result of the agreements. Furthermore, EI's financial benefits and low risk have the consequential effect of being detrimental for EGDI. Schools offered the following examples to demonstrate these concerns:

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- ECSI benefits by receiving a new CIS system, working to specifications;

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- EI benefits from a long term contract, (to December 31, 2006), between EGDI and CWLP;

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- EI benefits from CWLP's right of first refusal to match any third party offer, while EGDI has a weakened opportunity to receive competitive offers;

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- CWLP/EGDI contract terms lack of clear definition of "default", "material impact", and other key terms, improving CWLP's position and weakening EGDI rights;

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- the fixed fee per transaction payment terms benefits CWLP by protecting it from increased call frequency;

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- the CWLP/EGDI contract lacks a clear cut enforceable obligation for CWLP to bring forward opportunities to reduce costs under the contract;

330

- damages to EGDI are limited to the amount of annual fees;

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- the arbitration clause is optional, not mandatory, in the event that the presidents of EGDI and CustomerWorks are not able to resolve any dispute, with the help of mediation. In Schools view, Enbridge Inc. would never allow the matter to go to arbitration;

332

- the performance standards including time frames for performance set out in the service schedule are not necessarily considered material duties or obligations under the contract and EGDI can only terminate the contract if CWLP defaults "in the performance of its material duties or obligations under the contract". Material is not defined in the contract;

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- neither B.C. Gas Inc. nor Enbridge Inc. have guaranteed the financial viability or performance of CWLP; and

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- scope changes that could reduce unit fees must be agreed to by both parties and agreement is subject to the same concerns surrounding arbitration.

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Schools also expressed a number of concerns with the Accenture/CWLP arrangements, pointing to EI’s earnings motivation in establishing the arrangements. In advancing the Accenture/CWLP proposal to the Enbridge Inc. Board, Mr. Letwin stated that:

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> CWLP has been seeking new partners and after evaluating several options it was determined that a proposal from Accenture yielded the highest return to CWLP shareholders.

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Schools observed that the same could not be said about EGDI and its ratepayers.

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Schools also noted several advantages to CWLP in the arrangements for customer care for EGDI customers, as provided by the Accenture contract.

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In Schools' view, a combination of incentives and penalties to CWLP guarantees that EGDI will not be permitted to negotiate on a proper arm’s length basis with Accenture, either before or after December 31, 2006. Also, EI would not allow EGDI to negotiate reduced content scope and/or reduced rates.

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In Schools’ view, the contracting arrangements are highly prejudicial to the utility's ratepayers and the conflict of interest they pose for EI are serious. Schools requested that the Board require that

EGDI tender this service, in an unbiased manner, as soon as possible, and without the restraints imposed in either the CWLP contract or the Accenture contract.

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School Boards urged the Board to direct the Company and Enbridge Inc. to renegotiate their agreement with CWLP so that for all years from 2005 onwards the amounts payable by EGDI to CWLP do not exceed the amounts payable by CWLP to Accenture/CWI, net of all rebates and other benefits, plus any costs directly incurred by CWLP in providing the services. School Boards submitted that this renegotiated agreement should be filed by the Company in the 2005 Rates Case.

342

VECC noted that Mr. Louth was critical of several features of the EGDI arrangement relative to B.C. Gas Utility, such as the unit fee based pricing, the lack of flat fee option and absence of a cap on renewal price increases. VECC observed that Mr Louth shows that a flat fee per customer as negotiated by B.C. Gas Utility would save EGDI just under $5 million per year relative to the negotiated unit pricing.

343

VECC suggested that in the longer term, EGDI should be encouraged to enter into a direct, commercial arms length relationship with Accenture or another third party service provider for customer care services. VECC noted that such an arrangement could require the third party to acquire the remaining assets of ECSI/CWLP needed to provide the services, at fair market value.

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2.15 The Company’s Reply - Contract Terms

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In reply to the criticisms of Schools and CME, the Company pointed out the following:

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- CWLP has no guarantee of steady cash flows, as transaction volumes are not guaranteed.

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- The CSA requires CWLP to bring forward opportunities for efficiencies to EGDI. Related benefits are passed on to EGDI through scope changes. There is nothing in the CSA to prevent the realization of cost reduction benefits during the term of the contract;

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- Lastly, the Company has the right to tender to determine how best to proceed at the time of the CSA's expiry. In order to renew the CSA, CWLP is required to meet tendered prices from alternate service providers on a service by service basis. Further, there is nothing to prevent EGDI from moving certain customer care functions back into the Company if this is determined to be the best course of action.

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In response to the Schools concerns with the CWLP / CWI Program Agreement (the "Program Agreement"), the Company’s view is that CWLP's ability to achieve further earnings under the Program Agreement is speculative at best. The Company noted that any earnings beyond the terms of the initial contract between CWLP and the Company are premised on the following assumptions:

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- certain customer addition targets must be met;

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- EGDI must be converted to the new Peace CIS software;

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- should a new Peace CIS software application be installed for use by the Company, CWLP would own it and be subject to the risk of cost overruns due to scope changes; and

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- any revenue stemming from New Project Management Fees are only payable if the Peace CIS software conversion is done, which only goes ahead if the CSA is renewed.

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With respect to aspects of the Program Agreement dealing with CWI's rights upon the expiry of the CSA, the Company disagreed with Schools' concerns. The Program Agreement renewal provisions simply highlight the need for the Company to obtain valid reliable tenders if the fees under a renewed CSA are as low as they can be, which the Company will do in any case. The Company submitted that Schools' statement that "Enbridge Inc. will not let it happen" is unfounded and contradicts Mr. Letwin's testimony that EGDI is fully responsible for its negotiations of these arrangements.

355

The Company's submission is that the Program Agreement does not constrain EGDI's tendering abilities, but encourages it. In any event, regardless of who the service provider is, the Company acknowledged that it is incumbent upon it to validate its costs for rate-making purposes by demonstrating that it is paying a fair market price for services rendered.

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2.16 TPBR and Efficiency Gains

The Company's Position

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The Company based its argument in this case to the notion that the only relevant determination of the Board is whether the outsourced amounts proposed for the 2003 Test Year are reasonable for recovery in rates. The Company's position, therefore, is that it is not appropriate to embark on an enquiry into matters such as efficiency gains allegedly achieved by service providers.

358

The Company argued that the O&M "envelope" should not be reduced simply because service providers supplying outsourced services may have achieved efficiencies. The Company argued that this is particularly so in the following circumstances:

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- where the alleged efficiencies are achieved by service providers who deal with other customers in addition to EGDI;

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- when the implementation of an outsourcing arrangement preserves economies of scale and service levels to which customers had become accustomed before the unbundling of businesses;

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- where a service provider utilizes a CIS system in respect of which ratepayers never took any risk because it was never cleared to rate base before being transferred to the service provider;

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- when the intervenors base their position on a rebasing at the end of the TPBR plan, even though a full rebasing of O&M expenses has not occurred;

363

- when intervenors propose that ratepayers share in benefits achieved by non-regulated businesses without accepting responsibility for costs or risks;

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- when the Board has a set of rules governing transactions between a utility and its affiliates and those rules focus on market based or cost based prices without any suggestion that affiliates may be required to disgorge gains achieved from alleged efficiencies;

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- when, quite independently from any issue about alleged efficiency gains, the outsourcing arrangements deliver multifarious benefits to ratepayers;

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- when any further reduction to the O&M "envelope" would put into jeopardy the safe, reliable delivery of natural gas;

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- when, given current energy pricing, the Company actually needs to spend more on O&M to avoid losing market.

368

The Company further argued that utility ratepayers have already realized significant benefits from the TPBR plan. The Company pointed out that the TPBR plan had built-in features that ensured the capture of efficiency gains and cost reductions. One such feature was the 1.1% productivity improvement that was assumed during each year of the TPBR plan, which served to reduce costs for ratepayers by a total of $8.2 million. The rental rationalization Z-factor provided an additional $14.4 million of cost reductions. EGDI submitted that ratepayers also realized a reduction in rates during the term of the TPBR plan as a result of the asset sharing arrangement with Enbridge Commercial Services Inc.

369

The Company argued that the TPBR efficiency gains are clearly evident in its O&M cost per customer for 2003. In support of this assertion, the Company said that by the year 2000, EGDI had the lowest O&M cost per customer of any of the gas utilities for which data could be obtained. Further, the Company's original proposed O&M budget for fiscal 2003 produced an O&M cost per customer that was lower than in 1999 meaning that its customers were in a better position coming out of the TPBR term in respect of O&M costs than they were going into TPBR. Finally, when the O&M cost per customer evidence was updated to take into account the lower O&M "envelope" agreed to in the Settlement Proposal, the effect was more pronounced. Based on the amount agreed to in the Settlement Proposal, the Company claimed that its per customer O&M costs were lower than at any time since 1993, except for 2002, which was an abnormally warm year in which mitigation measures were undertaken by the Company.

370

Further, the Company conducted an internal study over the 1999 to 2002 period in which it claimed that it identified long-term productivity gains and cost reductions built into the 2003 O&M budget that total approximately $15.5 million. EGDI stated that without these efficiency gains, its 2003 O&M budget would have been substantially higher.

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2.17 Positions of the Intervenors - TPBR and Efficiency Gains

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CAC and other intervenors based much of their argument on the following premise: During the term of the TPBR plan, EGDI and its shareholder were to get the benefit of efficiency gains. However, at the end of the TPBR plan, the ratepayers were to get the benefit of any permanent efficiencies.

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In support of this position, CAC referenced the testimony of a Company witness at the oral hearing in EBRO 497-01 where the question of the sharing of efficiency gains at the conclusion of the TPBR plan was specifically raised:

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> Well, there is a sharing. The sharing happens when we rebase. And at that point in time, any permanent reductions in O&M that we've achieved, 0 per cent goes to the shareholder at that point in time and 100 per cent goes to the ratepayer at that point in time, so that's the sharing. (EBRO 497-01, Tr. Vol. 4, p. 506)

375

It was CAC's expectation in the EBRO 497-01 proceeding that the TPBR plan would create two principal forms of benefit for consumers, as follows:

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(1) The benefit of the productivity and "stretch" factors built into the TPBR formula; and

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(2) The benefit of efficiencies gained during the TPBR, which benefits were to flow to ratepayers upon rebasing, at the conclusion of the TPBR period.

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CAC disagreed with each of EGDI's arguments as to why efficiency gains realized outside of the utility should not be credited to ratepayers.

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CAC emphasized that EGDI's promise to deliver 100 per cent of savings to ratepayers at the conclusion of the TPBR period was not qualified in any way, and in particular, was not qualified by a distinction between efficiencies gained within a utility and efficiencies gained in an affiliate.

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CAC asserted that the materials produced in the Board's production orders were the first evidence in which it was clear that, from the very beginning of the TPBR period, EGDI never intended to give ratepayers the benefit of efficiencies transferred to affiliates.

381

CAC took issue with EGDI's assertion that the O&M would have been $332 million if it hadn't been for all the efficiency gains already credited to ratepayers. CAC submitted that the Board can

place no reliance upon it because there was no evidence to support that number, and so no opportunity to test it.

382

CAC and other intervenors contended that any suggestion that EGDI's ratepayers are not entitled to receive the full benefit of efficiencies, which would include any efficiencies that have been transferred to affiliates, would represent a breach of the "regulatory compact" underlying the TPBR plan.

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With respect to the "regulatory compact", CAC asked the Board to make the following findings:

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- that the "regulatory compact" underlying the TPBR plan requires that, at the conclusion of the TPBR plan, when rates are rebased, ratepayers are to receive the benefits of efficiencies realized during the TPBR plan, whether realized within the utility or in its affiliates;

385

- that, because of the terms of the "regulatory compact" underlying TPBR, the test to be applied to outsourcing arrangements is whether those arrangements are a benefit to ratepayers;

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- that, in order to ensure just and reasonable rates, both for fiscal 2003 and beyond, and to correct the disparity in the benefits received by ratepayers and shareholders that occurred during the TPBR plan, the annual amount of the efficiency gains transferred to affiliates in the last year of the TPBR plan should be deducted from the O&M figure agreed to in the ADR settlement namely $270M. To put the matter another way, efficiency gains realized in affiliates are not included in the $270M figure, but in order to properly rebase rates, they should be.

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CAC's witness, Dr. Bauer, summarized the result of the EBRO 497-01 case as follows:

388

> Overall, the plan can be classified as having high incentive power with the relatively limited sharing of efficiency gains by ratepayers during the plan period. An implicit expectation of such plan design is the ratepayer benefits will be realized at the time of plan review (or the return to cost-of-service).

389

CAC characterized the O&MDA as being reflective of the "regulatory compact" underlying TPBR. In CAC's view, the O&MDA will provide the necessary correction of the distortions in the distribution of benefits.

390

CAC took issue with EGDI's argument with respect to the way the Board should consider the TPBR plan which is that the test should be no detriment to ratepayers rather than a benefit to ratepayers. CAC said that its argument is based on the terms of the ARC. CAC's position is that the ARC is not determinative of the test to be applied in considering how to allocate the benefits of efficiency gains achieved during the TPBR plan, whether within EGDI or in its affiliates. The ARC governs the specific arrangements by which EGD is to deal with its affiliates. The ARC does not govern the terms of the TPBR plan. Under the terms of that plan, it is clear that the gains, or efficiencies, achieved

under the TPBR plan are to be transferred to ratepayers on rebasing. That, CAC submitted, is equivalent to a test of "benefit to ratepayers".

391

Energy Probe agreed with other intervenors that the original Board decision creating the TPBR plan did not distinguish between efficiency gains realized inside the utility and efficiency gains transferred to affiliates or other shareholder controlled entities like CWLP.

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Energy Probe also agreed with other intervenors that the evidence in this case clearly sets out the fact that a key element of EGDI's overall corporate strategy following the Board's EBRO 497-01 decision was to move TPBR efficiency gains out of regulation so that the shareholder could retain the efficiency savings created in the outsourced shared services.

393

Energy Probe urged the Board to find that unless EGDI can demonstrate significant harm to the utility and its customers, the major business transactions of EGDI should be conducted in such a way that these transactions can be routinely subject to regulatory scrutiny. Energy Probe offered that this finding would help to avoid the serious conflicts around disclosure that have sullied this case.

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In IGUA's view, the question to be answered is: What further reduction in actual 2002 O&M expenses (beyond the amount already identified by EGDI) would we see if all of the rationalization of utility resources that had taken place during the term of the TPBR plan had taken place in the utility or in affiliates that were wholly owned or substantially owned by EGDI rather than EI? IGUA submitted that once quantified, these O&M expense reductions should be taken into account in determining the final O&M expenses envelope for 2003 recoverable from ratepayers.

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To IGUA, the simple and straightforward objective of the TPBR plan initially proposed by EGDI in January 1998, when prior Board approval for affiliate transactions was required, was to provide EGDI with an incentive to reduce O&M expenses by rationalizing utility resources over the duration of the plan. In granting EGDI the privilege of executing the three-year TPBR plan, the Board's objective was to prompt EGDI to achieve sustainable O&M expense reductions, the benefit of which would accrue to EGDI's shareholder during the term of the TPBR plan. When the plan expired, the amount recoverable in rates would be reduced to reflect the lower level of O&M expenditures then being incurred. The shareholder wins during the term of the TPBR plan so that the ratepayer can win when the term of the plan ends. IGUA said that these straightforward objectives of the TPBR plan were reflected in the testimony of EGDI's witnesses in the EBRO 497-01 proceedings, EGDI's Argument in that case, and in the Board's EBRO 497-01 Decision.

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IGUA submitted that it was never envisaged that, at the end of the plan, EGDI would not account for all O&M expense reductions that had been achieved through the rationalization of utility resources that existed at its outset.

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Schools argued that EI and EGDI clearly intended to use the outsourcing/shared services customer care initiative to shield savings realized in ECSI and CWLP during the TPBR period from being passed on to ratepayers upon rebasing.

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Schools opinion was that in the fiscal period after the expiry of the TPBR plan, the utility would have to justify any additional O&M on the basis of truly incremental requirements.

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School Boards noted that all together the outsourcing arrangements represent more than $130 million out of the $280 million total O&M budget for the 2003 Test Year. School Boards commented that this has been a growing percentage of the expenses of the Company, and was a particular concern for two reasons: lessened transparency and return on equity.

400

School Boards said that outsourcing is a further opportunity for the Enbridge group of companies to make an additional profit out of serving the ratepayers. The generation of profits indirectly through outsourcing is more secretive, and thus it makes the Board's job more difficult. School Boards said that EI will choose the option that gives them the highest profit over time. School Boards said that this is in fact what EI did.

401

School Boards argued in three specific areas relating to EGDI’s outsourcing arrangements: (1) School Boards proposed set of principles to be used by the Company and others to design, implement, and then test outsourcing arrangements with affiliates; (2) School Boards analysed the actual amounts that should be given back to ratepayers with respect to the customer care outsourcing arrangements; and (3), School Boards presented a proposal for how this Board should fashion an order on the outsourcing issue.

402

VECC submitted that in order to judge the level of O&M that is appropriate upon rebasing, actual expenditures in the previous year are indicative of what the utility can achieve.

403

VECC disagreed with the Company’s argument that actual expenditures in 2002 were artificially low because certain "unsustainable" cost reductions were made to protect the shareholder from the consequences of unusually warm weather because these cost reductions may have simply been postponed expenditures, i.e. expenditures postponed during TPBR plan to the benefit of the shareholder, and now to be brought back into the Test Year budget and paid for through rates.

404

VECC also disagreed with the Company’s assertion that the target 1.1 % "served to reduce costs for ratepayers by a total of $8.2 million" because the record in the TPBR case shows that historic productivity improvements of at least 0.67% would have been expected from the Company even without a TPBR plan, so that the amount gained by ratepayers is considerably less than the amount claimed.

405

VECC further disagreed with the Company’s argument that low ROE levels during the period of the TPBR plan indicated that management was severely challenged by warm weather conditions in attaining earnings for its shareholder. VECC asserted that to the extent efficiency gains were exported to affiliates through outsourcing, one would expect lower rates of return in the utility. VECC said that the risk of warmer weather is one of the risks that the shareholder bears, just as the shareholder stands to benefit from colder than forecast weather.

406

VECC submitted that the O&M settlement amount of $270 million for 2003 provided the Company with a very reasonable budget given the historic trend in O&M, the 2002 O&M expenditures, and the budget that would be obtained by applying the TPBR formula to the 2002 figure. VECC disagreed that the budget represented an "efficiency gain" of $35 million on the basis that the original budget proposed was some $305 million. VECC indicated that the Company cannot generate "efficiency gains" to ratepayers simply by setting their proposed budget at the conclusion of the TPBR period at an unreasonably high level.

407

VECC agreed with the other intervenors and argued that the fundamental premise of the TPBR plan is that “what has been good for the shareholder in the TPBR period is good for the ratepayer upon re-basing”.

408

2.18 The Company’s Reply - TPBR and Efficiency Gains

409

The Company agreed with the intervenors that the TPBR plan was intended to provide the Company with an incentive to reduce O&M expenses during its term. There would be a rebasing of O&M expenses at the end of the plan, and to the extent that the Company had achieved lasting reductions in its O&M expenses, ratepayers would receive the benefit of such reductions on rebasing. The sustainable reductions in O&M expenses achieved by the Company would be built into the O&M expense level at the time of rebasing. The Company asserted that at no time did the Company propose, or the Board determine, that rebasing would involve an accounting of efficiencies not already reflected in the O&M expense level existing at the end of the term of the plan. The Company further asserted that at no time did a rebasing of anything other than the Company's O&M expense level become an element of the TPBR plan, even though the possibility of outsourcing to affiliates during the term of the plan was raised during the course of the EBRO 497-01 proceeding.

410

The Company explained that when evidence was given in EBRO 497-01 that 100 per cent of permanent cost reductions would go to the ratepayer on rebasing, the witness referred to "permanent reductions in O&M". The Company challenged the intervenors’ reliance on this evidence about ratepayers receiving 100 per cent of reductions because it does not address the fact that what the witness was talking about was permanent reductions in the Company's O&M, that is, the level of the Company's O&M expenses existing as at the end of the term of the plan. The Company maintained that it was never part of the scope or structure of the TPBR that, on rebasing, ratepayers would receive the benefit of all efficiencies, "regardless of where or how they were generated".

411

The Company further maintained that when the subject of affiliate outsourcing was specifically raised during EBRO 497-01, the Company's evidence addressed the subject in a way that could not have left any impression that rebasing would involve an enquiry into affiliate costs and efficiencies.

412

The Company said that it did not create expectations in EBRO 497-01 that affiliate outsourcing would be addressed on rebasing by means of a review of efficiency gains outside the Company. The Company said that affiliate outsourcing would be addressed on rebasing through a review of the prudence (i.e., reasonableness) of the costs paid by the Company.

413

The Company stated that its position on the efficiency gains question is that at the end of a PBR plan, the Board reviews and determines what it costs to run the utility at that time and then the "efficiency gains" achieved during PBR "are what they are". To the extent that the utility has truly achieved sustainable efficiency gains, the gains will be built into the numbers used for the Board's review and determination of the real costs of operating the utility.

414

The Company emphasized that it did submit detailed evidence on the costs of running the utility on a sustainable basis in 2003 and that it was prepared to undergo a line-by-line scrutiny of the O&M expenses. The Company said that because there was no such review the result was that there is no record upon which the Board can conclude, as contended by VECC, that there are efficiency gains achieved within the utility which are not reflected in the agreed-upon O&M envelope. The Company further noted that the words of the Settlement Proposal setting out the intervenors' position regarding the O&MDA do not suggest in any way that the amount recorded in the account should reflect efficiency gains achieved within the utility.

415

The Company stated that there is no sound and reliable method for making a determination of any efficiency gain transfers as contended for by intervenors. This is shown clearly by the wide range of approaches, and the wide range of numbers, put forward by intervenors in their arguments. The intervenors are the ones who framed, propounded and advanced this issue and yet the positions they have brought forward in final argument vary by tens of millions of dollars.

416

The Company argued that, in any event, the Board need not be concerned about the lack of a sound method for making any determination of alleged efficiency gain transfers, because this arbitrary exercise is simply inappropriate for the fixing or approving of just and reasonable rates for 2003.

417

2.19 O&MDA

418

2.20 Positions of the Intervenors - O&MDA

419

CAC’s witness, Dr. Bauer, was asked how the Board should determine the amount of efficiency gains transferred to affiliates through outsourcing arrangements. His response was as follows:

420

> Well, since there are no market prices available, there are no proxies available that meet the needs of the regulatory proceeding, the only way to do this would be to look at the cost of the service provider and start from the cost of the service provider to assess the efficiency gains that were realized in an affiliate.

421

CAC submitted that in order to arrive at an amount to be captured in the O&MDA, an amount which most accurately reflects the difference between the fees embedded in rates and the service provider's costs is appropriate. CAC said that this was consistent with the approach advocated by Dr. Bauer and is consistent with the provisions in the ARC.

422

CAC calculated an amount as follows:

423

$148.2 million - costs recovered in rates

424

less $ 91.1 million - service provider costs

425

less $ 13.5 million - savings within EGDI

426

Total: $ 43.6 million

427

CAC therefore proposed that this $43.6 million be allocated to the O&MDA.

428

Energy Probe calculated an O&MDA amount based on the costs of the service provider. Energy Probe suggested that the Board should consider concentrating on the 2002 realized efficiency gains. The Board should also consider three factors when reviewing the O&MDA suggestions. First, Energy Probe submitted that the payments made by EGDI to ECSI reflect $18.3 million in payments for CIS services are not based on a Board-approved recovery of CIS costs. Second, Energy Probe stated that in ruling on the O&MDA, it is important to appreciate that outsourcing has been proven to be a strategy for achieving efficiencies that can be effective. Third, in ruling on the O&MDA, Energy Probe suggested that the Board should take into account the Company's overall O&M level.

429

Energy Probe suggested that the appropriate quantum for the O&MDA is $40 million.

430

IGUA urged the Board to find that as of 2002 the range of PBR savings that EI has attempted to lock in for its ongoing benefit through the CWLP, EOS, and EGS arrangements are at least $23.2 million but probably $34.0 million.

431

IGUA submitted that the Board should find that had the rationalization of all utility resources that existed at the outset of the TPBR plan taken place entirely within the utility, then the sustainable O&M expense reductions in the utility in 2002 would have been lowered by an amount of at least $30 million.

432

Schools suggested that the appropriate standard for measuring the amount of efficiency gains through outsourcing during a PBR program in a given year is the service provider's profits in that year.

433

Schools cautioned that the transfer of efficiency savings to CWLP/Accenture can be expected to last for many years into the future absent the Board's intervention.

434

Schools stated that there will be a need to monitor the financial statements of CWLP over the next several years, to see what additional cost savings are being realized and how if at all, these savings are being reflected in lower EGDI payments pursuant to the EGDI/CWLP agreement.

435

Schools view was that the $270 million 2003 O&M amount in the Board approved Settlement Proposal needs to be reduced by approximately $13 million to reflect the savings that were transferred from EGDI to its affiliates, ECSI/CWLP/Accenture, EOS, and EGS, over the three years of the TPBR plan. Schools also said that amounts need to be reflected in the rebasing process in EGDI's next PBR program.

436

School Boards submitted that the evidence allows the Board to identify with some precision a reasonably reliable number representing the amount the utility is being overcharged for customer care. That number can be based on either:

437

a. The amount by which the Accenture price for the customer care services is less than the amount being paid by EGDI for the services (i.e., the "overprice" amount); or

438

b. The amount by which the "cash on cash" return of Enbridge Inc. from its investment in CWLP exceeds an appropriate amount (i.e., the "overearning" amount).

439

School Boards submitted that both of these amounts are simple and straightforward to calculate for the years 2003 and 2004 and that furthermore, these calculations inform the Board sufficiently to allow it to make numeric decisions on the O&MDA.

440

In summary, School Boards calculated the overearnings amount for 2003 ranges between $9.8 million and $15.5 million. The overearnings amount for 2004 ranges between $14.5 million and $17.7 million.

441

School Boards submitted that this Board should add the amount of $12.9 million to the 2003 O&MDA, and should direct EGDI to clear that account on October 1, 2003, by a one-time payment to all customers pro rata in accordance with their distribution rates paid in the Test Year.

442

VECC suggested that the immediate relief required is for the Board to:

443

a. Deem an amount of O&M reflecting the efficiency gains realized outside the utility and to order EGDI to enter this "excess" into the 2003 O&MDA.

444

b. Direct that any future regulatory calculation based upon the overall approved 2003 O&M level first deduct the excess referenced in (a)

445

VECC submitted that the Board should direct EGDI and its affiliated parties to provide the Board with proposed cost-based pricing for the balance of the term of the ECSI/CWLP Accenture arrange-

ment for customer care services that correctly reflects the service provider's costs as required under the ARC.

446

VECC's submission was that its gross margin analysis showed that the amount of O&M reduction ratepayers are entitled to receive from efficiency gains transferred to ECSI/CWLP is at least $21.4 million.

447

2.21 The Company's Reply - O&MDA

448

The Company cited the evidence of Dr. Bauer who made specific recommendations to the Board about the approach to be taken in respect of affiliates in this case as follows:

449

(1) if better evidence is available, it is preferable not to have to examine the costs and earnings of unregulated affiliates;

450

(2) the first choice is to get competitive market information;

451

(3) in circumstances where it does become necessary to look at information from an unregulated affiliate, what the Board should be assessing is whether there is an excessively high return;

452

(4) the excessive return that the Board should look for is one that lastingly exceeds the return considered normal for a firm in that business and/or risk class; and

453

(5) even if the Board does find the existence of such a lasting excessive or supernormal return, that itself is not sufficient evidence on its own of a "shifting of profits".

454

The Company held that CAC, IGUA and VECC have each presented an analysis of an amount to be recorded in the O&MDA that bears no relationship to the principles that their own expert witness, Dr. Bauer, said that the Board should follow.

455

The Company presented the O&MDA amounts proposed by intervenors and made what it reasoned were the necessary corrections to those numbers. The following table shows the O&MDA amounts and the Company's suggested "corrections".

456

Table 1 - O&M Deferral Account Amounts
($ millions)

	School Boards	Schools	VECC	IGUA	CAC	Energy Probe
Proposed Amount	12.9	13.0	21.4	30.0	43.6	40.0
Adjustments: Less: TPBR cost base variance					(9.6)	(6.0)
Less: PBR savings adjustments				(16.5)		
Less: Margin on IT and Fleet				(8.6)		
Less: non-Enbridge ownership (30%)	(3.9)		(6.4)		(28.4)	(28.4)
Less: non-EGDI related earnings		(3.7)	(6.2)			
Earnings	9.0	9.3	8.8	4.9	5.6	5.6
Utility's return on Capital	8.0	8.0	8.0	8.0	8.0	8.0
Competitive Environment return on Capital	?	?	?	?	?	?
Over/(under) Earnings	1.0	1.3	0.8	(3.1)	(2.4)	(2.4)

457

The Company's "corrections" included the removal of the 30% of CWLP earnings that relate to B.C. Gas' ownership of CWLP. Also, any non-EGDI related earnings were removed. The Company argued that the only valid measure of the Company's contribution to Enbridge Inc.'s earnings as a result of its relationship with CWLP are the earnings and return on investment achieved by ECSI. Also, earnings generated by CWLP from other entities such as B.C. Gas and other third parties should not be included in calculating over/under earnings of the affiliates. Ratepayers should not enjoy the benefit of earnings CWLP was able to generate from third parties. Even if the Company had continued to perform the customer care business functions internally, any related earnings would have been considered non-utility returns.

458

The Company's "corrections" to all of the submissions of the parties effectively yielded an O&MDA balance of nil.

459

2.22 Other Submissions

460

IGUA suggested that there was other harm done to ratepayers, in addition to the efficiency gains question. IGUA said that as a result of the successive arrangements between EGDI, ECSI, CWLP and Accenture/CWI, there has been a transfer and ultimate disposition by EGDI and EI of their ownership interests in EGDI utility customer care resources, including the intangible value of the know-how and expertise that the utility personnel acquired during their tenure as EGDI employees.

461

IGUA argued that the transactions have taken place without leave of the Board and are a contravention of s.43(1) of the Ontario Energy Board Act. EGDI and EI have clearly disposed of EGDI's customer care resources. Customer care resources are an essential component of providing monopoly service to the public.

462

IGUA stated that the intangible value of the expertise and know-how, which has been monetized by EI as a result of the CWLP Accenture/CWI transactions, is a value associated with an intangible asset in which EGDI ratepayers are entitled to share.

463

IGUA further submitted that EGDI ratepayers are entitled to a share of the scale benefits and the portion of market growth revenues that EI eventually realizes through its 70% interest in CWLP. For example, such benefits were identified in the recently announced contract between Accenture and B.C. Hydro and were estimated to be $385,000 in 2003, and more than $500,000 per annum thereafter.

464

2.23 Board Findings

465

The Issues and Organization of Findings

466

The Board sees the issue in this chapter as primarily an O&M rebasing exercise, as the Company emerges from its TPBR period.

467

The Board has organized its findings for this chapter in the following manner:

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- First, there is a discussion about the nature of the services provided and the Board's approach to the ARC, fair market value and the question of efficiency gains.

469

- Second, the Board will make specific findings on the outsourced customer care costs in relation to the O&MDA.

470

- Third, the Board will address the need for tendering of outsourced customer care services.

471

- Fourth, the Board will note its concerns with the customer care contract terms.

472

- Fifth, the Board will provide its findings in relation to the costs of the EGS and EOS out-sourcing arrangements including the need for tendering of these services.

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- Sixth, the Board will make findings on ECSI in relation to the O&MDA.

474

- Seventh, the Board will address the need for filing of service provider cost information.

475

- Eighth, the Board will address the ARC review and the proposed School Boards principles.

476

The Nature of the Services in Question

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The ARC distinguishes between two kinds of services, those for which a market is available, and those for which a market is not available. Where a market exists for a particular service, a utility is required to pay no more than the fair market value for the service. Where no market exists for a particular service, a utility is required to pay a cost based price which includes a return component

that is the higher of the utility's approved rate of return or the bank prime rate. Based on the evidence in this proceeding, there is no dispute that the customer care service is one for which a market exists. The other outsourced services at issue are ones for which no market existed at the time that the Company entered into contracts with EOS and EGS.

478

A key decision the Board must make is the approach it will use to determine the O&MDA issue. In the Board's view, there are fundamentally two alternative approaches. Intervenors have largely focussed on an examination of the costs and revenues of the outsourced service providers, and the costs to the utility in an effort to both determine where efficiencies may have been realized and to quantify those efficiency gains. The other approach, which is the approach argued by the Company, is to examine the reasonableness of the amounts being charged by the outsourced service providers. The Company's view is that the fees are reasonable and that they have produced the appropriate evidence to support this view.

479

The Board notes that a number of the intervenors argued that EGDI had, in effect, promised delivery of all achieved efficiency gains upon rebasing at the conclusion of the TPBR plan, whether generated within the utility or outside of it. CAC termed this as a "regulatory compact" made between EGDI and its stakeholders.

480

The Board notes that no party disputed that EGDI could seek out efficiencies during the term of the TPBR plan and in fact many parties pointed out that incenting this behaviour is precisely the intention of performance-based rate making. It appears to the Board though, that the issue is not necessarily about where the efficiencies originated or departed, but rather that the rebased O&M costs capture all available efficiencies.

481

In the Board's opinion, the attempt to track the cost efficiencies that the various service providers may have achieved is an exercise that is fraught with difficulty. The fact that the intervenors arguing for an O&MDA amount could not agree on either a methodology or an amount attests to this difficulty.

482

On rebasing after a PBR plan has expired, the primary issue is about establishing the appropriate cost of the service. The Board's view is that upon rebasing at the end of the TPBR plan, to the extent that sustainable efficiency gains exist, they should be built into the numbers put forward for the Board's determination of the costs of running the utility. The primary exercise for the Board is to ensure the proposed O&M budget of $270 million and its component parts represent reasonable costs to be borne by the ratepayers.

483

Section 2.3.3 of the ARC provides:

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> Where a fair market value is not available for any product resource or service, a utility shall charge no less than a cost-based price, and shall pay no more than a cost-based price. A cost-based price shall reflect the costs of producing the service or product, including a return on invested capital. The return component shall be the higher of the utility's approved rate of return or the bank prime rate.

485

In the context of services being provided by affiliates at the time of rebasing, the Board is of the view that the appropriate question to be asked is the one that arises from the ARC, and that is: Are the prices being charged by the affiliates for the outsourced services fair market value prices where a market exists for those services or, where a market does not exist, is the price a cost-based price, including an appropriate return component?

486

Board Findings on Customer Care Costs

487

The evidence clearly discloses that a market exists for customer care. It is equally clear that the Company did not go to the market to obtain its customer care services. Two Company witnesses, Mr. Riedl and Mr. Letwin, indicated that one of the reasons for this choice was the fact that the Company wanted to avoid the stranding of the customer care CIS assets that had not been included in the Company's rate base.

488

This choice does not alleviate the Company's obligation to establish that the price being paid for customer care is no greater than fair market value, an obligation that the Company has acknowledged. The Company's approach was to provide evidence that the overall O&M budget is reasonable, and within that budget, that the amount for customer care represents fair market value.

489

To demonstrate that the price it is paying for customer care represents fair market value, the Company relied on the benchmarking evidence of Dr. Lowry and Mr. Louth, as well as a 1999 report produced by Computer Sciences Corporation, an anonymous tender carried out by E-Source in 2000, and an assessment of the Company's CIS solution and outsourcing agreement with ECSI done by MICON Consulting Inc. in 2000.

490

EGDI has built its case for establishing the reasonableness of its outsourced customer care costs by "validating" the prices it pays using the following tools:

491

- by comparing its costs per customer against other utilities;

492

- through cost surveys in which it participates;

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- engaging consultants such as Mr. Louth and Computer Sciences Corporation to perform cost "reasonableness" reviews; and

494

- through an anonymous tender.

495

The evidence on customer care services provides a range of costs representative of what other utilities are paying. The Board notes that there was a wide range of results in the various cost comparison studies of customer care costs, including the transcript undertaking of Mr. Louth, Exhibit J27.3. In response to that undertaking, Mr. Louth applied a Canada/ United States exchange rate of 1.4, which was more reflective of the current exchange rate, to recalculate his cost comparison figures. He also recalculated the cost comparison figures using the OECD purchasing power parity

factor ("PPP") for Canada of 1.2, as a way of controlling for currency exchange fluctuation. It is clear from the results of this transcript undertaking response that the cost comparisons are sensitive to changes in currency exchange rates between Canada and the United States.

496

Data was extracted from Mr. Louth's undertaking and further analysed by the Board, as follows:

497

Table 2 - Customer Care Costs per Customer ($)

Sample Mean	EGDI Cost per Customer	Canada / US Exchange 1.4	Differential with EGDI	Annual Differential (based on 1.6 million customers) ($ millions)
Gas Utilities	59.59	58.06	1.53	2.4
Electric Utilities	-	55.26	4.33	6.9
B.C. Gas	-	54.53	5.06	8.1

498

Sample Mean	EGDI Cost per Customer	Canada / US PPP factor = 1.2	Differential with EGDI	Annual Differential (based on 1.6 million customers) ($ millions)
Gas Utilities	59.59	52.17	7.42	11.9
Electric Utilities	-	49.12	10.47	16.8
B.C. Gas	-	54.53	5.06	8.1

499

As shown in the table above, the Company's customer care costs per customer compare unfavourably with those of B.C. Gas. As B.C. Gas is a Canadian utility, currency exchange is not a factor in the comparison. B.C. Gas and EI, the Company's parent, are both partners in CWLP, who provides customer care to both the Company and B.C. Gas. Unlike the Company, B.C. Gas was required to obtain regulatory approval for its customer care arrangements with CWLP. The Company's customer care costs are $5.06 per customer higher than those of B. C. Gas.

500

The above evidence, while not leading to a determination of fair market value, has been useful as a comparison and in establishing a range of values. This leads the Board to the conclusion that the price EGDI pays for customer care services is higher than fair market value. The range of this "overprice" amount is between $2 million to $17 million higher than fair market value.

501

As a result of this conclusion, it is necessary to determine what disallowance would be appropriate. The Board recognizes that the evidence does not provide a precise figure for the difference between the price the Company pays and fair market value. The Board notes that much of the cost comparison data is dated and sensitive to changes in currency exchange rates. The purchasing power parity factor is not a definitive tool and there is a lot of variation in the sizes of utilities that were compared. In comparing the Company to B.C. Gas, it is important to recognize that there are some differences in factors that influence the operations of the two companies, such as climate. The Board also accepts that it may not have been the most desirable option for the Company to go to the marketplace for customer care because this could have led to the stranding of a significant CIS asset.

502

The Board notes that confidential undertaking J21.1 essentially represents a pro-forma profit and loss statement for CWLP which shows the earnings of the partnership. It includes a calculation of CWLP's return on invested capital for 2003. The 2003 Board-approved rate of return on total capital for EGDI is 8.32%. The Board notes that it can roughly estimate the CWLP earnings and invested capital attributable to EGDI by basing it on EGDI's percentage contribution to revenues. On this basis, the comparison shows that the difference between CWLP's return on invested capital and EGDI's approved return on total capital would yield an excess of $5.2 million in earnings before interest and taxes (EBIT). This analysis would suggest to the Board then, that CWLP is "overcharging" the Company by at least $5.2 million in 2003, given that the Board has not tested CWLP's costs. In 2004, a similar analysis would yield a figure of $7.7 million.

503

The Board also notes that if the TPBR plan had been extended to the 2003 test year, the O&M allowance would have been $259.3 million (based on the TPBR formula, excluding Z-factors), roughly $10 million below the $270 million O&M budget.

504

In view of the above tests for reasonableness, the Board deems a disallowance of $7.0 million. The Board notes that this disallowance: is below the midpoint of the range of the "over-price"amount; is lower than the B.C. Gas cost differential; is within the "overcharging" amounts calculated; and results in an O&M level above that resulting from extrapolating the TPBR formula. The Board directs the Company to post a $7.0 million credit to the 2003 O&M deferral account.

505

The Board notes that the 2004 Settlement Proposal provides for an adjustment to the level of fiscal 2004 rates, in the event that the Board finds a disallowance for 2003. The 2004 Settlement Proposal provides in scenario 2(d) in section 1.2, that "the 2004 O&MDA Amount shall be the amount determined by the Board for 2003, increased by 90% of the inflation factor". The Board directs that this adjustment be implemented.

506

Board Findings on Tendering and Contract Terms

507

In the Board's view, a fundamental weakness in the Company's approach to establishing that the price it is paying represents fair market value is the lack of a fair and open tendering process. In the Board's opinion, such a market-based process would have left considerably less doubt about whether fair market value has been achieved for the outsourced customer care services.

508

The Board is of the view that an open tender for EGDI's business would prove to be the most appropriate method to establish fair market value for customer care service. The Board notes that the Company acknowledges its right to tender and has alluded to this eventuality as an "opportunity to test its CWLP prices in the marketplace". Mr. Letwin stated that at the time that the CWLP contract comes up for renewal, the Company, and the other customers of CWLP, will have some "very significant opportunities to renegotiate their contracts with CWLP if they don't like what they're getting". Furthermore, Mr. Letwin commented, in the context of the EGDI/CWLP arrangement, that "you could see ECG [EGDI] make a decision at the end of 2006, not to continue with this relationship".

509

The Board also notes that several parties expressed concern with the contractual terms underpinning the outsourcing arrangements. These concerns centered around a common theme that Enbridge Inc. appears to derive financial and risk benefits at the expense of the utility ratepayers. For example, Schools offered the following examples to demonstrate these concerns:

510

- EI benefits from CWLP's right of first refusal to match any third party offer, while EGDI has a weakened opportunity to receive competitive offers;

511

- the CWLP/EGDI contract terms lack of clear definition of "default", "material impact", and other key terms, improving CWLP's position and in weakening EGDI’s rights;

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- the CWLP/EGDI contract lacks a clear cut enforceable obligation for CWLP to bring forward opportunities to reduce costs under the contract;

513

- damages to EGDI are limited to the amount of annual fees;

514

- the arbitration clause is optional, not mandatory, in the event that the presidents of EGDI and CustomerWorks are not able to resolve any dispute, with the help of mediation;

515

- neither B.C. Gas Inc. nor Enbridge Inc. have guaranteed the financial viability or performance of CWLP.

516

The Board notes that Schools identified several advantages to CWLP in the arrangements for customer care as provided by the Accenture contract. Schools stated that these have the potential for negative effects on EGDI.

517

The Board is concerned that certain features of the contracts may inhibit the utility’s ability to obtain the best possible arrangements, including price. In particular, the Board is concerned with the “right of first refusal” clause in the CWLP contract, a clause found objectionable by several intervenors and the Company’s own witness, Mr. Louth. The Company failed to convince the Board that this clause provides any material benefit to the Company or its ratepayers, while substantial evidence and argument convinced the Board that it could have a significant dampening effect on EGDI’s ability to seek and receive competitive bids. The Board expects that its concerns with the contracts will be addressed in any new contract.

518

The Board observed the difficulty the Company had in this proceeding to establish a fair market value for the outsourced customer care services, services which the Company agreed were available in the marketplace. While the Board acknowledges the Company’s right to select the process by which it obtains its services, the Board believes the use of an open tendering process would assist in establishing the fair market value and reduce the risks of possible disallowance of costs. The Board suggests that the Company take these comments regarding tendering and contract terms into consideration when reviewing its outsourced customer care arrangements.

519

Board Findings on EGS and EOS Costs

520

The Board notes that the original transfer prices for services provided to EGDI from EGS and EOS were developed using the utility's historical cost of performing the function. Based on the evidence, it appears to the Board that the transfer prices are now developed using the service provider's current budget costs. The Board also notes that a corporate cost allocation is included in the transfer price.

521

The Company said that at the time of outsourcing, there were no market pricing benchmarks available and that this is why the costs were based on the utility's fully allocated costs of providing the services. The Board accepts this.

522

The Board has reviewed the financial information provided in this proceeding and concludes that EGS and EOS do not appear to be earning excessive returns. In fact, EOS showed an operating loss in 2002. The Board notes that it was not provided with pro-forma financial information for EOS's 2003 year. There is no evidence to suggest that the creation of EGS and EOS has resulted in a detriment to the utility, in a financial sense. The Board therefore accepts the costs as reasonable for recovery in 2003 and 2004.

523

The Board notes that the Company indicated that the services agreements with EGS and EOS provide for a review of the fee schedule and available market pricing benchmarks every two years and there is a further provision for an amendment to the fees coming out of the review, "if necessary".

524

The provisions of the ARC require that where a market exists for a particular service, the utility is required to pay no more than the fair market value for the service. The first matter before the Board is to determine whether or not a market exists. The evidence in this proceeding has not convinced the Board that no market exists for these services. The Board would be assisted by clear evidence with regard to the existence of a market for gas services and operational services, and believes that an open tender would assist in establishing this fact. If the Board can be convinced that no market exists, then the Board will be guided by the ARC with respect to cost-based pricing.

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Board Findings on ECSI Costs

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The Board notes that segmented financial statements that isolate the EGDI portion of ECSI's business were provided for the calendar years ending 2001 and 2002. The Board notes that no 2003 financial projections were provided for ECSI.

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The Board observes that ECSI has undergone significant business changes over the past several years. Some of these changes include:

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- the transfer of its customer care business to CWLP on January 1, 2002;

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- the impact of the sale of the competitive energy services business to Centrica, plc. in July of 2002; and,

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- the cessation, as of September 30, 2002, of the provision of information technology and fleet management services to the utility.

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It appears to the Board that these events have resulted in ECSI being significantly scaled back in its scope as a common service provider. The record is not clear about exactly what remains in ECSI in terms of service provision directly to EGDI because some of the changes were taking place during the course of this proceeding.

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The Board notes that there was a temporary arrangement in place with ECSI regarding the repatriation of ECSI employees to the utility. The employees were to be transferred to EGDI effective January 1, 2003.

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The Board examined ECSI's return on assets relating to EGDI for the years ending December 31, 2001 and December 31, 2002. The Board finds that the 2001 and 2002 return on assets as disclosed in the confidential exhibit X21.1, do not cause a concern for the Board because the returns do not exceed the utility's Board-approved return on capital. The Board further notes that there has been a change in the business plan at ECSI, and this has resulted in a more indirect relationship with the utility as a result of its provision of CIS services to CWLP. The Board finds that there is no requirement for an O&MDA amount for ECSI in either 2003 or 2004.

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ECSI remains an outsourced service provider and continues to have an indirect relationship with the utility, through CWLP. It may be too early to "close the chapter" on ECSI. The Board therefore directs that the segmented financial statements for 2003 and 2004 that isolate the EGDI portion of ECSI's business, including the return on invested capital, together with a description of the services being provided to EGDI, be filed in EGDI's next main rates filing. To the extent that actuals are not yet available, the Board expects pro-forma financial information to be filed.

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Board Findings on Cost Data

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The Board will require affiliate cost information until such time as open tendering is available to establish market prices. Therefore, the Board directs EGDI to file cost-of-service details for the affiliated service providers that are the subject of this proceeding in its 2005 rate case filing. The Board requires information that clearly discloses the financial details related to the services provider's provision of services to the utility. The information should also include the return on invested capital used to provide services to the utility.

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Board Comments on ARC Review

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The Board is presently undertaking a review of the Board's *Affiliate Relationships Code for Gas Utilities*and will be issuing any proposed amendments for comment as part of this review.

539 The Board notes that School Boards advanced a number of “principles” which would govern a utility’s relations with affiliated service providers. The Board regards these principles as suggestions or proposals for revising the ARC and would be best brought forward in the ARC review process.

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3 CORPORATE COST ALLOCATIONS

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3.1 The Issue

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This issue arose from a substantial increase in the costs allocated to the utility by its corporate parent, mostly as a result of a new corporate cost allocation methodology introduced by the Company in this proceeding.

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The parties' understanding of the fairness of these higher costs was complicated by a very significant corporate restructuring, decentralization of utility control and decision making, and the new cost allocation method itself.

544

In the Settlement Proposal, all parties agreed that the $270 million O&M expenses "envelope" for 2003 covered all of the corporate cost allocations on the condition that policy issues related to the corporate cost allocations remains an unresolved issue to be explored in the hearing. The Board notes that its decision in the Company's fiscal 2004 rates case was based upon the 2003 approved rate structure and that there was no specific adjustment for the quantum of the corporate cost allocation components of the utility costs for 2004. Therefore, the first occasion for considering the corporate cost allocation issue, in the context of setting rates, will be in the 2005 rate year.

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3.2 Background

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In 1999, EI adopted a "one company, one vision" strategy, as part of its movement to an "integrated" model in the operation of its diversified corporate structure, where the corporate office played an active role in the activities of its business units. Previously, a holding company model, referred to as a "HoldCo" model, was employed in which EI provided primarily corporate oversight. EGDI submitted that the integrated model provides opportunities for efficiencies, improved information flows and cost reductions, and ensures that appropriate levels of risk are assumed.

547

The new structure finds EI providing service to EGDI in three forms. First, the Centres of Excellence program involves services from certain functional areas including human resources, public affairs, tax, audit services and risk management. Second, the continuation of centralized administration of other functional areas includes the services of Treasury and Pension Administration. Third, the provision of expertise by functionally experienced staff at EI ensures that strategy, policy direction, and application are consistent across all Enbridge business units.

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The evolving corporate structure has been accompanied by significant increases in the corporate cost allocations from EI to EGDI, as follows:

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- 1999..$1.9 million

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- 2000..$5.2 million

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- 2001..$8.6 million

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- 2002..$11.6 million

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- 2003..$21.8 million *

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* Based upon a new Cost Allocation Methodology

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The 2003 corporate cost allocation was based upon a new cost allocation methodology, which the Company submitted was a more structured allocation framework because it was more comprehensive and transparent, but at the same time simpler to apply. EGDI submitted that the prior cost allocation methodology had been fee-based and was administratively burdensome because of the significant amount of time required to effect inter-company billings, reconciliations, and dispute resolutions.

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3.3 Positions of the Parties

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Company's Position

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The Company argued that the evidence demonstrates that the shared corporate services were prudent and the costs were appropriately allocated to EGDI. The Company said that the benefits exceed the allocated costs.

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The Company submitted that EGDI benefits from the services provided by EI in terms of cost efficiency due to spreading of costs across business units and quality of service due to high level of technical expertise employed in these services. The Company confirmed that in considering the corporate structure, EGDI and EI had been mindful of the Board's EBRO 493/494 Decision relating to Westcoast Corporate Centre ("Westcoast") charges to Union and Centra Gas Ontario Inc. ("Centra") in which the Board indicated that it had:

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> no conceptual problem with a Corporate Centre approach to shared services, provided the economies of scale and other operating efficiencies of the Centre result in the delivery of required services to [the utility] on a more cost effective basis than the [utility's] own costs of providing the same services.

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The Company argued that the new cost allocation methodology used in 2003 more accurately reflected the true costs of the services that EI provided to EGDI, and that this was one reason why there was an increase in the amount of the allocations to EGDI in 2003. In essence, EGDI said that it had been underpaying for the corporate services prior to 2003.

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EGDI described their guiding principles for the new cost allocation methodology:

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- it must be simple;

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- it must allow for consistent use across the enterprise;

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- the allocation must be fair to all parties;

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- the methodology must meet the requirements of the various regulatory authorities by ensuring there was no cross-subsidization;

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- the methodology must not result in additional income taxes;

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- allocated costs must be transparent to management so that it can continue to control costs; and

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- the basis for allocating costs must be understood and supported by the corporate and business unit offices.

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The Company referred to paragraph 5.5.14 of Board's EBRO 493/494 Decision with Reasons where the following three-pronged test ("three-pronged test") for evaluating the appropriateness of proposed Westcoast charges related to Union and Centra was summarized:

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- Cost incurrence - were the corporate centre charges prudently incurred by, or on behalf of, the companies for the provision of services required by Ontario ratepayers?

572

- Cost allocation - were the corporate centre charges allocated appropriately to the recipient companies, based on the application of cost drivers/allocation factors supported by principles of cost causality?

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- Cost/Benefit - did the benefits to the company's Ontario ratepayers equal or exceed the costs?

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The Company evaluated its corporate cost allocations against the Board's three-pronged test.

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Cost Incurrence: According to the Company, EI cost allocations to EGDI met the cost incurrence test both generally and specifically. Generally, the policies espoused through the provision of the corporate services allowed EGDI to meet high standards of corporate governance, employee conduct, and operational excellence, which result in a high level of customer and investor confidence in Enbridge and its subsidiaries. At a more specific level, the provision of following corporate services to EGDI show how critical they are to EGDI's business:

576

- EI's Treasury department, in conjunction with the EGDI's Law department and the EI's Corporate Law department, manages the prospectus preparation and filing process for the issuance of debt capital. The experience of the Corporate Law department, gained from working on EI's financing and security matters, complements the skills of EGDI's internal legal counsel.

577

- EI's Corporate Controllers group also plays an important role in this process and EGDI's financial statements are prepared by its accounting staff with assistance from the EI's Corporate Controllers group. The EI Controllers Group ensures the financial statements reflect up-to-date accounting standards, and is an active lobbyist on behalf of rate-regulated enterprises from an accounting standpoint.

578

Cost Allocation: The Company argued that the corporate charges were allocated appropriately to the utility. EGDI referred to the logic of the cost driver approach and the principles of cost causality considered in EBRO 493/494, together with the Ernst & Young report which it filed in support of the new methodology. According to that report, each cost or group of costs was allocated under the Enbridge methodology using a basis that reflected the cost drivers that management believed appropriately reflected the benefits received and the cost of the services provided.

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Cost/Benefit: The Company stated that the following benefits to the utility's Ontario ratepayers equal or exceed the costs of the services provided:

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- replacement benefits - the services provided replaced an equivalent service at equal or lower cost;

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- synergistic or linkage benefits - the services allowed the utility to reduce costs by means of being part of the larger corporate group and thus operating in concert for the procurement of products and services; and

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- stand-alone benefits - strategic actions and activities instituted by the [corporate office] that produced direct value to the utility.

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EGDI argued that, in addition to the quantifiable corporate service benefits, there were a number of administrative benefits and other intangible benefits identified in the evidence.

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EGDI further argued that it had ensured that the relevant sections of the ARC had been complied with. The Company stated that the Intercorporate Services Agreement satisfied Section 2.2.1 of the ARC and pricing of the service was also consistent with Section 2.3.3 of the ARC. The Company stated that in the absence of a fair market value for the types of the services provided by EI to EGDI, the charges for these services were based on EI's fully-burdened, or fully-allocated cost of providing these services without any additional mark-up for a profit component or a return on investment.

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Positions of the Intervenors and Company Reply

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The intervenors expressed considerable concern about the magnitude of the corporate services charges. CAC and Schools noted the increase from $1.9 million in 1999 to $21.8 million in 2003. VECC noted that the new corporate allocation methodology resulted in allocating over 90% of total corporate costs to subsidiaries with about 33% of that amount to EGDI. IGUA argued that the magnitude of the increases in EI's costs since 1999 should not be overlooked when assessing the appropriateness of the results of the new approach.

587

VECC stated that Company's characterization of an integrated system versus the HoldCo structure, was of little consequence and that the key tests for rate recovery of the corporate charges were found in the EBRO 493/494 and EBRO 497 Decisions, and the ARC. Schools added that the distinction between the holding company and an operating company was nothing more than an artificial construct.

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VECC and IGUA disagreed with the Company's claims that the new corporate cost allocation methodology was superior to that established in the EBRO 493/494 and EBRO 497 Decisions. Both submitted that the existing framework is superior and more adequately protects ratepayers from inappropriate downloading of corporate costs.

589

In reply, the Company argued that the new cost allocation methodology is sufficiently different from the prior way that charges for corporate services had been determined and rendered, and that any comparison with prior year allocations was inappropriate. The Company suggested that the Board conduct a review of the corporate cost allocations with "fresh eyes" or a "zero-based approach".

590

With respect to the first prong of the three-pronged test, cost incurrence, CAC argued that although some services provided by EI may be required by EGDI, the Company had not demonstrated that all of the services were required or that the allocation amounts accurately reflect the level of service provided to EGDI.

591

CAC and IGUA submitted that with respect to the second prong of the three-pronged test, cost allocation, there is nothing inherently wrong in adopting cost allocation methodologies which employed the use of cost drivers. However, CAC stated that it is also important to ensure that the application of cost drivers is supported by the principles of cost causality and that EGDI failed to demonstrate that the cost allocation to EGDI for 2003 was supported by the principles of cost causality.

592

With respect to the third prong, cost/benefit, IGUA stated that there was no independent objective evidence addressing this. VECC argued that EGDI had not demonstrated that the net benefits resulting from centralizing corporate functions is positive and that there is primarily conjectural evidence to justify any estimate of the amount that EGDI would be paying in the absence of the centrally provided services. CAC and IGUA argued that the annual salaries, on average, were almost 100% higher ($101,121 versus $54,178) than those of EGDI, suggesting that EGDI could provide the same types of services within the utility for a lower cost.

593

In commenting on the Ernst & Young Report, CAC and IGUA argued that during the cross-examination it became apparent that the scope of the review was very limited and that Ernst & Young relied entirely on information provided by EGDI and EI, without audit or independent verification. IGUA also argued that Ernst & Young did not assess whether the corporate services benefited ratepayers, quoting from the Board's Decision in RP-2001-0032 that EGDI "must demonstrate not only that the arrangements will not harm ratepayers, but also that there will be a significant and tangible benefit to ratepayers." CAC submitted that given the limited scope of the study, it cannot be relied on to justify the new cost allocation methodology or the amounts flowing from it.

594

In response to intervenors' arguments that the Company failed to provide independent objective evidence that addressed the prudence of EI's corporate charges, EGDI stated that verification of the evidence of utility and affiliate employees by an independent expert was no more a Board requirement in the case of corporate cost allocations than it was a requirement for any of the utility's other costs of service. In response to arguments that Ernst & Young did not audit or independently verify the budgeted amounts, the Company submitted that besides the extra time and cost that this kind of audit would require, this would have been an unnecessary duplication of the work that EGDI had already done to verify for itself that the department budgets proposed by the EI department managers had been reasonably accurate.

595

Responding to concerns about the average salary differential, EGDI stated that the differential in average salaries reflects the employee population mix in EI and EGDI with EI having a higher percentage of professional staff and executives due to the nature of the function of a head office.

596

Some intervenors argued that the intercorporate services represented an untendered affiliate outsourcing arrangement and should be considered in the context of the ARC. School Boards maintained that the functions provided by EI to EGDI could otherwise have been provided by EGDI internally; therefore, corporate cost allocations should be considered as "outsourcing".

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VECC noted that the new Intercorporate Services Agreement had replaced the following individual services schedules:

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- Audit Services

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- Government relations

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- Risk management

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- Taxation Services

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- Gas Storage Advisory and Consulting

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- Treasury Services Agreement

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- Management Fee Agreement

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- Labour Relations

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- Total Compensation Services

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with a Confirmation Notice/Sign-off sheet that set only the "allocated costs" that EGDI was required to pay for each "service", but did not include the following information as required by Section 2.2.1 of the ARC:

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(a) the type, quantity and quality of service;

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(e) the apportionment of risks (including risks related to under or over provision of service)

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EGDI replied to VECC's criticisms by reiterating that the cost allocation methodology approach is consistent with the ARC and the principles set out therein, and that having more detailed services schedules in place for the recurrent corporate services would provide no significant benefits. Moreover, the Company said that the creation of these services schedules would require additional time and effort, and therefore expense, that would be factored into operations and maintenance expenses of the utility.

611

Further, the Company said that the schedule to the current intercorporate services agreement provides, among other things, a clear description of the corporate services being provided. The description provided is high level because the cost allocation methodology allows for the fact that the annual process for review and discussion of forecast services may result in small changes to the details of the services to be provided. The Company said that in large part, these corporate services are recurrent in nature, and they are reviewed and revised, if necessary, on an annual basis.

612

The Company further indicated that the quantity and quality of the corporate services is also ensured by the annual review of services, and the confirmation notice sets out the charge for the year in question. The annual review of forecast services and budgets further ensures that any over or under provision of services during the year is addressed. Therefore, the Company said that a provision dealing specifically with apportionment of risks during the year is also not required for recurring services.

613

The Company replied that, regardless of its characterization as either shared services or outsourcing, its corporate services arrangement with EI was fully compliant with all the Board's rules and that it was important for the Board to understand the context within which the corporate services were provided. The corporate services provided by EI are of a strategy, policy, and standards-setting nature, and to achieve efficiencies and organizational consistency, these services are centralized and shared. The departments that provide these services complement each other and work

together to complete the required functions. As such, they did not lend themselves to being out-sourced.

614

In responding to Schools assertion that EGDI should have issued tenders for certain services for which competitive markets exist, the Company noted that Schools had disregarded the nature of the corporate services generally, and also failed to distinguish between services procured from outside professionals and the services provided by in-house personnel.

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Schools, School Boards, VECC and IGUA submitted that allocating the cost of “managing the investment” was already found by the Board to be non-recoverable in rates and is an example of a service that must not be allocated to the utility.

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The Company replied that the Board’s past statements with respect to “minding the investment” were case and fact-specific statements made in the context of applying the regulatory principles espoused by the need and benefits tests. In the context of this proceeding, EGDI and EI had endeavoured to set out in detail the need for and benefits of the corporate services. The Company stated that, although some of the corporate services could be said to have an investment management or governance component, this was not determinative of whether they were of benefit to EGDI and its customers. The Company submitted that the evidence of EGDI and EI witnesses demonstrated that the services were required by the utility and that they provided benefits.

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CAC, IGUA, VECC, School Boards and Schools collectively argued that there was no link between the charges for aviation services and the actual services being received. They further argued that the use of “capital employed” as a cost driver was inappropriate versus a cost driver like “time spent”. School Boards stated that using “capital employed” as a cost driver was that the corporate office, not being capital intensive, received a very low allocation of 0.69%.

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In response to intervenors’ arguments, that “capital employed” had been inappropriately selected rather than “time spent” for allocation of aviation costs, the Company replied that just as timesheets were not appropriate allocation factors for other corporate services such as CEO and Investor Relations because of the integrated nature of the services provided, time logs would not be the best proxy for actual aviation costs. The Company stated that, according to the evidence it submitted, capital employed was used to allocate aviation costs because the benefits to the business units were most closely associated with the size of the investment that entity represented rather than other factors.

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VECC submitted that the Board could make findings either of a generic nature (e.g. categories of costs) or as a disallowance of a quantum of corporate allocations that would affect the year 2004 O&M base.

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In response to VECC’s argument, the Company replied that Section 7.1 of the Settlement Proposal contained an express statement that the $270 million O&M expense envelope included the corporate cost allocation amounts. Therefore, the Settlement Proposal presumed that the $270 million expense envelope considered all of the quantum issues associated with corporate cost allocations, explicitly for the Test Year, but also implicitly for the 2004 O&M base because of the very nature of EGDI’s 2004 application.

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3.4 Board Findings

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The Board notes the significant increases in corporate cost allocations to EGDI from the corporate office during the period 1999 to 2003. The $21.8 million corporate cost allocation proposal represents an 88% increase over the $11.6 million amount billed by EI for 2002, reflecting mainly the change in the cost allocation methodology. The Board is concerned about this significant increase in the corporate cost allocation budget and the potential for cross-subsidization.

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With respect to the proposed cost allocation methodology, the Board finds that the scope of the Ernst & Young review was too narrow and therefore did not provide a sufficiently thorough analysis of the corporate cost allocation question. The Company relied mainly on its own witnesses to defend the new corporate cost allocation methodology and as a result, there was no independent evaluation of the reasonableness of the resulting allocations to the utility . The Board notes that in the EBRO 493/494 case, an independent consultant was retained to assess the reasonableness of the resulting allocations of the new methodology.

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Further, the Board notes that under cross-examination, EGDI's witness, Mr. Turner of Ernst & Young, confirmed that the three reports prepared in the EBRO 493/494 case in respect of Westcoast's corporate centre charges were, collectively, a more thorough examination of the issues of corporate allocations than that undertaken in this proceeding. The Board believes that there is merit in taking a similar approach to the evaluation of the corporate cost allocations and any new cost allocation methodology. The Board therefore directs the Company to obtain an independent audit/review of its new corporate cost allocation methodology for the services it receives from EI. The Board's expectation is that the study and its results will be made available during the 2005 rate case and that this evidence will be considered by the Board in its determination of fiscal 2005 rates.

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The Board expects that the following requirements will be fulfilled in the independent review of the new corporate cost allocation methodology:

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- the study should assess how the Company's proposed cost allocation methodology compares with the Board's past decisions and how it complies with the *Affiliate Relationships Code for Gas Distributors*;

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- the review should assess whether the "three-pronged test"established in the EBRO 493/494 Decision has been properly applied by the Company;

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- with respect to the first prong, cost incurrence, the review should identify the functions provided, and amounts assessed, by EI which do not meet the "needs" of the utility;

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- with respect to the second prong, cost allocation, the study should review the cost drivers of the new corporate cost allocation methodology and assess them in terms of meeting the "cost causality" principle. The review should also include a comparison of the proposed cost drivers with the cost drivers used in the past by the Company and identify the need and reasons for any changes;

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- with respect to the third prong, cost/benefit, the review should establish, in a quantifiable manner, if the benefits resulting from the functions performed by the corporate office exceed the costs to the utility and ratepayers;

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- the study should propose revisions or adjustments to the methodology and the cost allocation amounts; and

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- it should include a review of the new Intercorporate Services Agreement and the evaluation of the need for individual services schedules.

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The Board suggests that in developing the terms of reference the Company may wish to consult with interested parties. The Board acknowledges that this may result in other items being added to the terms of reference.

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The Company may recover the costs of the independent review through a deferral account set up for that purpose.

635

On the issue of the Intercorporate Services Agreement, the Board shares the concerns raised by VECC that the Intercorporate Services Agreement may not adequately address section 2.2.1 of the ARC, which identifies information to be included in the services agreement, especially the information required in sub-sections (a) and (e). The Board is of the view that to the extent that the required information has not been provided, it must be provided in the next rate filing. The Board also anticipates that the independent reviewer will consider this matter and render an opinion.

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4 WORK AND ASSET MANAGEMENT SOLUTION (“WAMS”)

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4.1 Background

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In the RP-2001-0032 proceeding, EGDI filed a proposal to implement a Distribution Plant Work and Asset Management system, referred to as DPWAMS. This $20.5 million project was intended to encompass work order generation, work and resource planning, work tracking and monitoring, and work analysis for the entire life cycle of EGDI’s distribution assets.

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In its Decision with Reasons RP-2001-0032, the Board did not approve of the DPWAMS project. The Board stated: “Prospective rate-making requires that the utility must advise the Board of its intended actions and forecasted costs in advance of the test year. The plans must be real and not hypothetical and management must be committed to implementing these plans. The Board is not prepared to scrutinize a project and “pre-approve” a project before the Company’s management is committed to it”.

640

In the current proceeding, the Company indicated that it was still evaluating alternatives and that it made a provision of $4.5 million in O&M expenses to cover the estimated cost of a potential out-sourcing arrangement related to securing a DPWAMS solution.

641

The Company said that, in September 2002, it initiated a formal Request for Proposal (“RFP”) process and chose Accenture as its Application Service Provider (“ASP”) and that the Company signed a letter of intent with Accenture on January 30, 2003. The Company indicated that Accenture would provide EGDI with an appropriate work and asset management system in order to enable existing employees to implement and administer the work management function and that no employees would be transferred as a result of this arrangement. At the time of the hearing, the Company said that it was in detailed discussions with Accenture on the requirements of the work and asset management system.

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EGDI considered a new work and asset management system (“WAMS”) solution to be a business necessity caused by the aging of systems that EGDI needed in order to be able to continue to provide safe and reliable delivery of natural gas. The WAMS solution was required to:

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- reduce the reliance on in-house developed applications that no longer adequately support the business;

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- deliver the IT enabled tools required to support operational activities;

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- standardize and optimize business processes;

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- enhance performance and profitability; and

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- provide decision support tools to enable operational excellence.

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The Company indicated that the annual fees payable to Accenture would be $7.1 million in fiscal 2003, $10.2 million in fiscal 2004, $6.0 million from 2005 to 2009, and $3.0 million in fiscal 2010, for a total of $50.3 million over the life of the project. EGDI stated that it intended to capitalize 50% of Accenture's annual service fee since the project supports the Company's construction activities.

649

The Company stated that the annual benefits would be $7.0 million in fiscal 2004, $12.0 million from 2005 to 2009, and $6.0 million in fiscal 2010, for a total of $73.0 million over the life of the project.

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EGDI stated that in comparing the WAMS project with the previously proposed DPWAMS project with the same discount factor, the Board-approved ROE of 9.54% and a term of six years, the net present value (NPV) of the WAMS project was $8.66 million, compared with an NPV of $7.6 million for the DPWAMS project.

651

The Company stated that its decision to contract for a work and asset management system with Accenture as an ASP on a fee-for-service basis removed the requirement for the Board to approve a multi-year capital project.

652

In the Settlement Proposal, there was an agreement to settle the WAMS issues in the following manner:

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> "The cost consequences of this issue are covered by the settlement of Issue 7.1 [Overall O&M levels for 2003] on condition that the unresolved policy matters listed at Issues 7.45 [Unresolved policy aspects of specific issues relating to O&M] and 8.1 [Outsourcing arrangements for 2003] are to be addressed in the hearing."

654

In its May 1, 2003 oral decision on the motion brought by CAC for the production of the Accenture Agreement, the Board made the following finding:

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> "Having accepted the ADR agreement, the Board is of the view that it is not necessary to require production of the Accenture agreement for the purposes of this proceeding. The recovery of costs associated with the WAMS project may well be an issue in subsequent proceedings, and this has been acknowledged by the Company, through its witnesses. However, this is a settled issue for the purposes of the current proceeding. The Board recognizes that the need to produce the Accenture agreement may be an issue in a subsequent proceeding."

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4.2 The Company's Position

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EGDI argued that the WAMS proposal was superior to the original DPWAMS project in that it provided increased benefits at a reduced risk to the Company. Specifically, the WAMS proposal allowed the Company to benefit from the extensive utility experience of Accenture and the lower risk fixed-fee arrangement. According to the Company, the risk of this IT project was reduced even further as a result of the post-implementation support that EGDI would receive from Accenture.

658

The Company submitted that there was no issue left for the Board to decide in respect of the WAMS issue in this case given the Board's acceptance of the Settlement Proposal. In support of this position EGDI noted the Board's May 1 decision on the motion for the production of the Accenture Agreement.

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4.3 Positions of the Intervenors

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Intervenors accepted that for the purpose of rates for 2003, recovery of the costs associated with the WAMS project is a settled issue. However some intervenors requested that the Board make certain determinations with respect to the WAMS project.

661

CAC, IGUA and VECC requested that the Board confirm that its approval of the Settlement Proposal was not to be interpreted as a finding of prudence or approval for all subsequent costs related to project during the term of the contract with Accenture. They submitted that the Board should direct EGDI to bring forward for approval in future rates cases the costs to be recovered for this project, supported by evidence to demonstrate the functionality of the project, quantitative evidence that the benefits were being delivered and a justification for the annual cost levels.

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CAC noted that the WAMS project was not in place, was not a proven technology, and its costs would amount to $50 million over the next ten years

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VECC argued that no evidence had yet been provided for the approval of the total financial implications of WAMS and the additional expenditures for the field force technology.

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IGUA submitted that, at the time of cross-examination, EGDI had not signed a final contract with Accenture and that any finding of prudence by the Board, at this time, would be premature since the Board had not been provided with the final WAMS contract.

665

School Boards agreed with the Company that there was no live issue to decide in respect of WAMS in this rate case. Further it submitted that the Board should decline to provide any endorsement that the WAMS proposal was prudent and met the needs of the utility.

666

School Boards commented that the real issue raised in this case, driven in part by the shift in the information technology world from large capital projects to outsourcing of functions to third party application service providers (ASPs), is the appropriate regulatory treatment of such outsourcing.

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School Boards submitted that there were two options for the Board to consider:

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1) Expressly advise the Company that, in the event it entered into long-term ASP commitments, the Board should make such contracts subject to regulatory approvals on an annual basis, or

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2) Adopt a rule that long-term ASP commitments should be approved by the Board prior to their start. This would involve a full review of an ASP commitment in the same manner as a major capital project.

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School Boards commented that the second option provided several benefits when compared to the first option. These benefits included consideration of the whole project as one entity, greater certainty for the Company with regard to the recovery of the costs, similarity of regulatory treatment for capital and ASP projects, and an opportunity for the Board to get a closer handle on such ASP projects that appear to be a growing component of utility costs. School Boards submitted that the Board should advise the Company that future ASP commitments should be brought to the Board in a rate case for a detailed life-cycle review, before the Company committed itself to the project.

671

School Boards submitted that the new rule should not be applied to the WAMS project, but that the Company remains technically at risk each year for the payments to the ASP under that commitment.

672

4.4 The Company's Reply

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The Company submitted that it was committed to bringing forward evidence on costs for the WAMS project in future rate proceedings, should the nature of the application necessitate such evidence. However, it cautioned that any future review of the WAMS project must adequately balance the risks and the rewards of the project and be consistent with accepted prudence review principles and that hindsight should not be used.

674

In response to the School Boards submission, the Company stated that it would welcome guidance with respect to how ASP projects should be considered and approved by the Board, and that it would support a Board directive that facilitates application and approval for multi-year IT projects, regardless of the project structure. EGDI agreed with the School Boards that, in addition to the benefits identified by the School Boards, the greater certainty for all involved that would result from multi-year project approvals was a desirable regulatory objective.

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4.5 Board Findings

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The Board reconfirms that the WAMS proposal is a settled issue for the purposes of the current proceeding in determining rates for fiscal 2003. The Board agrees with the intervenors that its approval of the Settlement Proposal for WAMS should not be interpreted as a finding of prudence. The Board notes the Company's commitment that it will bring forward evidence on costs related to the WAMS project in future proceedings, should the nature of the application require such evidence. The Board notes that EGDI's current contract with Accenture for the WAMS project is on a "fee-for-service" basis and therefore, its cost consequences will be part of EGDI's O&M proposals in future rate proceedings. The Board expects the Company to file such evidence as necessary to support the recovery of costs related to the WAMS project in future rates proceedings.

677

The Board notes that School Boards asked the Board to provide guidance (in the form of a "new rule" for a detailed life-cycle review and prior Board approval) to the Company and the intervenors on how ASP projects should be considered in the context of the shift from large capital projects to outsourcing of functions to third party ASPs. The Board is unwilling on the basis of a proposal raised in argument and not discussed in any great depth in the hearing itself, to make detailed findings on School Board's proposal in this case. The Board acknowledges that these recommendations may be worthy of further examination.

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5 EnTRAC

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5.1 Board Decision on Energy Transaction, Reporting, Accounting and Contracting (“EnTRAC”)

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The Board issued an oral decision on the Company’s proposed EnTRAC project on Day 16 of the hearing, April 16, 2003. The following is the verbatim transcript of the decision.

681

883 DECISION:

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884 MR. BETTS: Welcome, everybody, as we reconvene this session.

683

885 The Board was asked earlier to make its best efforts to issue an early decision on the issue 6.4 relating to EnTRAC, and the Board is now in a position to issue that decision orally. The Board has reached a decision on Issue 6.4 relating to Enbridge Gas Distribution Inc.'s Energy Transaction, Reporting, Accounting and Contracting (EnTRAC) information technology project.

684

887 The Company's position is summarized as follows:

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888 The Company is seeking Board approval of the EnTRAC project in four areas:

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889 (1) the EnTRAC project in principle;

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890 (2) an expenditure of up to $18 million;

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891 (3) to close $6 million to rate base in fiscal 2003; and

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892 (4) the appropriate methodology to allocate costs.

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893 EGD argued that its existing legacy systems are aging and are not capable of managing the increasingly complex direct-purchase agreements and the growth in direct-purchase customers. EGD also indicated that the existing systems lack the flexibility to respond to changes in the market environment such as changes contemplated by the Gas Distribution Access Rules (GDAR).

691

894 EGD explained that the existing systems do not provide up-to-date information. Hence, the Company is not able to accurately forecast and determine purchasing requirements for

load-balancing supply and system gas customers which, in turn, results in customer impacts through the PGVA.

692

895 EGD submitted that EnTRAC will produce benefits to all ratepayers in the areas of: reduced contract processing effort, legacy application maintenance, hardware and software reductions, reduced gas costs, shortened Banked Gas Account settlement periods, service provider savings, liability exposure, load growth potential, reduced future development costs, customer satisfaction, and employee satisfaction. EGD indicated that these benefits would be available to all ratepayers, not simply those with direct-purchase agreements or large-volume consumers.

693

896 With respect to the proposed cost of $18 million, EGD argued that the amount is reasonable and that no separate board of directors' approval was necessary for the EnTRAC project because it forms part of the company's overall budget that has already been approved by EGD's Board of directors. Moreover, EGD submitted that the company's executive team has endorsed the project.

694

897 EGD stated that a detailed development of project parameters was conducted and a formal Request For Proposals (RFP) was released. The Company asserted that the RFP process was objective and impartial to all participants.

695

898 With respect to cost allocation, EGD proposed to allocate EnTRAC costs on a basis similar to other information technology projects. In EGD's view, EnTRAC will generate benefits to all customers due to the impact on global system customers.

696

899 Mr. Dominy, would you continue.

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900 MR. DOMINY: Turning now to the positions of intervenors.

698

901 First, on costs:

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902 VECC, CAC and School Boards were concerned about the prudence and reliability of the project cost proposed by EGD. These parties were of the view that the RFP process was problematic.

700

903 School Boards and Schools argued that EGD did not properly conduct due diligence reviews on Sapient's financial health. Schools went on to argue that the Board should require the Sapient contract to include conditions to mitigate ratepayers' risks.

701

904 VECC noted that it is difficult to understand the underlying rationale of EGD's cost estimate.

702

905 In CAC's view, EGD is seeking an advance approval for an expenditure before there is evidence that the proposed investment would be used and useful.

703

906 CAC argued that other than EGD's assertion, there is no compelling evidence that EnTRAC is the appropriate solution, and that the proposed cost is appropriate. In particular, CAC argued that the RFP process is not in and of itself a measure of appropriateness of the cost.

704

907 School Boards and Schools were concerned that there is lack of information regarding the $3 million already spent and closed to rate base. Schools argued that the $3 million was closed to rate base without Board approval in 2002. As such, no return on that capital should be permitted going forward and that the amount of return paid should be credited back to ratepayers in 2004 rates.

705

908 School Boards was concerned that the NPV calculations include certain benefits, but exclude certain associated costs relating to those benefits. School Boards proposed that the Board authorize only the amount that can generate an NPV of zero or better.

706

909 Schools was of the view that the EnTRAC solution would allow EGD to respond to changing market conditions more quickly and effectively. However, Schools shared the concerns of other intervenors that it is difficult to judge whether the proposed cost is reasonable.

707

910 Schools proposed that the EnTRAC costs should be capped at $18 million or any amount determined by the Board. A cap should also apply to the proposed costs involved in ongoing system management of $400,000 per annum. In addition, Schools was of the view that EGD should not be allowed to seek further approval of additional costs incurred for scope change given the detailed work and the $3 million already spent in the design phase.

708

911 Schools was concerned that there is not sufficient evidence regarding the $3 million in costs related to the involvement of Customer Works Limited Partnership (CWLP).

709

912 IGUA supported EGD with respect to the necessity of the EnTRAC project. However, IGUA had concerns and questions with respect to the proposed budget. In particular, IGUA argued that EGD has not provided sufficient reasons to justify the selection of the most expensive bid response. IGUA was also concerned about the significant increase in non-vendor costs. IGUA submitted that it would be appropriate for the Board to approve the project but with a limited budget at this time with the proviso that the company can return to the Board in the next rate case and demonstrate the prudence of further expenditures.

710

913 With respect to the benefits achieved by EnTRAC within CWLP, IGUA recommended the Board direct EGD to track the benefits that EnTRAC would provide to CWLP, and to direct EGD to demonstrate in future rate cases that those benefits are being transferred back to the company.

711

914 OESC supported the company's EnTRAC initiative. OESC submitted that the evidence demonstrates that the project has been well conceived and well planned. OESC noted that the EnTRAC solution will be GDAR-compliant and will reduce the level of costs that would have been otherwise required to comply with GDAR on a stand-alone basis.

712

915 OESC submitted that the total cost estimate of approximately $18 million appears to be reasonable as it is comparable to the costs of the Union Line project estimated at $15.7 million. OESC noted that in its view, the Union Line project has not been designed with GDAR functionality in mind.

713

916 With respect to the cost allocation, VECC was concerned that the principle of cost causality was not relied upon. Both VECC and CAC argued that the benefits of EnTRAC are primarily enjoyed by large-volume customers and direct-purchase customers.

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917 CAC argued that EnTRAC is correcting problems that system-gas customers didn't cause in the first place. Hence, it is unfair to require residential customers to pay for the cost of fixing a problem that they didn't create.

715

918 VECC and CAC proposed to allow recovery of EnTRAC costs through the Direct Purchase Administration Charge (DPAC). CAC argued that a user-pay approach will enable a closer connection between cost causality and the payment of costs.

716

919 CAC was of the view that Union's unbundling proposal should not be adopted as there are clear differences between Union's and EGD's proposals.

717

920 IGUA and OESC argued that the EnTRAC project would result in benefits to all ratepayers. These parties therefore opposed the user-pay approach. Both parties supported EGD's cost allocation proposal. However, IGUA and OESC submitted that in the event the Board is convinced that there should be a departure from EGD's proposed allocation, the methodology approved in the Union Gas unbundling decision RP-2000-0078 should be applied.

718

921 In its reply submission, the Company argued that the EnTRAC project cost passes two tests of reasonableness. Firstly, it has been developed through an independent competitive bidding process. Secondly, the cost is comparable to Union Line, the only other comparable project in Ontario.

719

922 In response to intervenors' concerns about the extent to which the Company undertook to review Sapient's financial results, EGD submitted that Sapient is the service provider which was referred to the Company by Union and therefore Sapient has already demonstrated its credentials in that project. The Company was of the view that it is the shareholders' money that is being invested in the project and is at risk. To the extent that the project is developed and produces benefits, it would then be closed to rate base.

720

923 In addition, EGD submitted that the $3 million already spent on EnTRAC was the subject of a complete settlement in the fiscal 2002 rate case and is not a live issue that the Board needs to address in this proceeding.

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924 The Company reiterated its position that the cost allocation methodology should recognize not just the costs but also the system wide benefits.

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925 MR. BETTS: Now, the Board findings:

723

926 The Board notes that there was no settlement of this issue in the settlement agreement, except as addressed in issue 6.1, "Rate Base of the Settlement Agreement" addressing the amounts included in the 2003 capital budget. While parties were in general support of the objective of enhancing at a reasonable cost the information system required to manage agreements with large-volume customers and direct-purchase customers and associated gas supply management issues, there was less than full acceptance that the Company had proven that EnTRAC was the best way to achieve the necessary improvements.

724

927 The Board is convinced that improvements to the gas supply management system are required. There was no evidence contradicting EGD's assertion that EnTRAC was a reasonable solution to achieve the required improvements. The Board also accepts the Company's position that the EnTRAC project will accommodate the changes required by GDAR at a lower price for ratepayers than if the changes were done on a stand-alone basis.

725

928 Although intervenors raised concerns regarding the Company's RFP process, the Board is prepared to accept the selection of Sapient as a reasonable choice of service provider for the EnTRAC project. However, the Board is concerned with the increase in the non-vendor costs between the Company's original and updated proposals. In the Company's original proposal, $2.9 million out of a total cost estimate of $19.5 million was non-vendor cost whereas in the Company's updated proposal, $8.6 million out of a total cost estimate of $18 million was non-vendor cost. This represents an increase of $5.7 million in non-vendor costs between the two proposals. The Board notes that the Sapient cost is reduced from $16.6 million to $9.4 million while at the same time Sapient is taking on responsibility for more tasks in a fixed price contract.

726

929 With respect to intervenors' concerns about Sapient's financial health and the potential risks to ratepayers, the Board notes that prior to costs being closed to rate base, it is the shareholders' money that is at risk. However, this does not preclude the need for the company to conduct a thorough financial due diligence analysis of any investment.

727

930 The Board is prepared to accept this project in principle on the basis that the costs not exceed $18 million. The Board accepts the $9.4 million Sapient component of the project cost as being reasonable. However, the Board agrees with the intervenors that the remainder of the costs, that being the non-vendor costs, have not been fully justified. The Board is of the view that these non-vendor costs, including the arrangement with CWLP, are within the control of the Company. The Board directs the Company to set up an appropriate

deferral account to record these non-vendor costs as they are incurred. Any amounts recorded in this account will be examined for reasonableness at the time of disposition.

728

931 With respect to cost allocation, the Board expects that the EnTRAC project will produce system-wide benefits. Given the nature of the benefits, the Board is of the view that the most equitable approach to cost allocation is a cost allocation methodology where 50 percent of the cost will be allocated to rate classes on the basis of volumetric consumption, and 50 percent of the cost will be allocated to rate classes on the basis of customer count.

729

932 And that is the Board's decision.

730

6 OTHER ISSUES

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6.1 Manufactured Gas Plant Deferral Account

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The Company proposed to establish a 2003 Manufactured Gas Plant Deferral Account (“MGPDA”) to record the costs of investigating, defending, and dealing with any claims made in respect of properties allegedly contaminated as a result of the historic manufacture of coal gas. The Company indicated that the appropriateness of clearing these costs through to rates would be a matter to be considered in future applications.

733

The Company indicated that it is one of a number of individuals and entities that has been named in a lawsuit filed on February 21, 2003 by Cityscape Residential Inc. (“Cityscape”) in respect of coal tar contamination which is alleged to exist at the Gooderham and Worts historic distillery site in downtown Toronto, near the Company’s former Station “A” Manufactured Gas Plant. Cityscape alleges that coal tar contamination is the result of past operations at the Company’s facility there. The Cityscape lawsuit claims $50 million in damages and $5 million in punitive damages. This lawsuit has thus given rise to the request for the MGPDA.

734

In its written evidence, the Company stated that, although there are no known regulatory precedents in Canada, there are precedents in the United States for the recovery of costs incurred in the remediation of coal gas contaminated sites through rates. The Company specifically stated that it expects that if it is found that it must contribute to any remediation costs, it would generally be allowed to recover in rates those costs not recovered through insurance or by other means.

735

The Company testified that one reason for proposing the MGPDA is the quantum of the Cityscape claim. The Company indicated that if the account is not established, costs incurred in 2003 would not be transferable to a future year. The purpose of the deferral account is to record costs incurred in 2003 for later disposition.

736

On the issue of insurance coverage, the Company stated that while it has put many third party liability insurers on notice of the Cityscape claim, no insurer has admitted that coverage exists and no insurer has yet agreed to assume the defence of the Cityscape action. The Company testified that there is no indication at this time that any of the costs of defending or dealing with the Cityscape claim and any other claim arising out of the operation of manufactured coal gas plants will be assumed or paid for by any of the Company's existing or former insurers.

737

Positions of the Intervenors

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CAC, IGUA and School Boards are opposed to the creation of the 2003 MGPDA. Some of the reasons submitted by these parties include:

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- Lawsuits against EGDI should not be the subject of deferral account protection. EGDI ratepayers are not responsible for the failure of the owners and operators of the utility to exercise reasonable care in the performance of their duties.

740

- EGDI should not be entitled to look to ratepayers as insurers of last resort. For EGDI and its shareholders, prudent management of EGDI's affairs included the duty to mitigate risks through, among other actions, the securing of appropriate insurance. If the claims are not insured, then it is arguable that any judgment against EGDI on account of such claims is a shareholder risk and therefore these costs can and should be managed by EGDI.

741

- The legal, investigative and administrative expenses relating to this matter are O&M expenses and as such should be considered as part of the settled O&M budget for the Test Year.

742

- The current shareholder of the Company purchased the Company in 1994. At that time it had notice of the potential of these liabilities, and had ample opportunity to investigate and determine the extent of them. Hence, the shareholder should be considered to have satisfied itself that any risk associated with manufactured gas plants was one the shareholder was willing to take.

743

- The ratepayers of today should not be put in a position where they are bearing costs associated with ratepayers of 50 to 150 years ago.

744

VECC took no position on the establishment of the account on the understanding that there is no assumption in creating the account that it will be cleared to ratepayers.

745

Schools agreed with the establishment of the account in 2003 on the understanding that the question of who will pay is yet to be determined.

746

Energy Probe suggested that, given the issue involves a recent filing of a specific claim against EGDI, it is appropriate for the Board to find in favour of a limited manufactured gas plant deferral account for this specific claim alone. If further issues of this type arise, the Company should be required to bring them forward for consideration in a timely manner.

747

CAC suggested that if the Board decides to accept the proposal to create this deferral account, it should be on the explicit understanding that: (1) ratepayers are not, as a general rule, to be regarded as EGDI's insurers; and (2) that ratepayers retain the right to object to clearance of the account on, among other grounds, the ground that they should not be responsible for the risks entailed in claims made against EGDI.

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The Company's Reply

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In response, the Company pointed out that the deferral account would be used to record costs relating to all MGP claims, not only that of Cityscape. This would include potential claims arising out of former manufactured gas plants elsewhere in Toronto and the Province.

750

The Company reiterated that it is the magnitude of the Cityscape and other potential claims and the costs of dealing with each that warrant the establishment of the deferral account. In addition, the costs to deal with the insurers could be substantial.

751

The Company disagreed with some intervenors' arguments that it should have anticipated the MGP claims since the Cityscape action was not served until February 2003, well into the Test Year. The Company submitted that the costs incurred in fiscal 2003 should not be treated differently from costs incurred at a later date.

752

Board Findings

753

The issue before the Board is a question of a lawsuit associated with a single site in Toronto, the Cityscape action. As such the Board questions the appropriateness and necessity of a more generic deferral account at this time.

754

Furthermore, the evidence presented in this proceeding is not adequate to convince the Board that a deferral account of either a generic or specific nature is required at this time. The Board is concerned that the mere existence of the deferral account may imply an expectation of future recovery by the Company. The Board therefore does not approve the creation of the MGPDA at this time.

755

The Applicant may reapply in the future for a MGPDA with greater details on the scope, potential costs, and grounds for any ratepayer responsibility for these costs.

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6.2 Deferred Rebate Account

757

As part of its Draft Final Rate Order for fiscal 2003, the Company filed a request to record in the 2003 Deferred Rebate Account (the "2003 DRA") the under-recovery of distribution revenues attributable to gas losses for the months of May and June 2003. The under-recovery resulted from a mismatch between the utility gas price underlying the calculation of distribution revenues and that underlying the calculation of gas supply charges. The Company testified that the under-recovery for the months of May and June would amount to approximately $570,000. The Company expected that the mismatch would be eliminated, effective July 1, 2003, as a result of the recalculation of the utility gas price forming part of its RP-2002-0133/EB-2003-0126 QRAM application. Because this recalculation did not take place the mismatch continued. The Company therefore requested that the period to record the under-recovery be extended to September 30, 2003. The total to be recorded in the 2003 DRA for the May to September period was expected to be $1.2 million.

758

The Company's position was that the Board should approve this request because the calculated revenue deficiency of $38.2 million, agreed upon in the Settlement Proposal, assumed a match between

revenues and gas costs. Without the proposed $1.2 million capture in the 2003 DRA, the Company would be exposed to a revenue shortfall of an equivalent amount. The Company stated that this request did not in any way alter the revenue deficiency agreed upon in the Settlement Proposal, but simply enabled the Company to collect the agreed upon revenue deficiency.

759

Positions of the Intervenors

760

Schools agreed with the Company's proposal.

761

IGUA pointed out that the intervenors were quite specific in limiting their exposure to delivery-related rate increases to a particular delivery-related revenue deficiency amount of $38.2 million.

762

IGUA submitted that if the deficiency amount being recovered by the Company is not $38.2 million but only $37.0 million because of the circumstances described by the Company, then the Board should allow the proposal.

763

On the other hand, IGUA submitted that if the additional $1.2 million results in recovery in excess of the agreed upon $38.2 million, then the relief requested ought to be denied.

764

Company's Reply

765

The Company confirmed that the currently approved rates would recover a revenue deficiency of $37 million, $1.2 million less than the agreed revenue deficiency of $38.2 million. The Company noted IGUA's position that should that be the case the Board should approve the Company's request. The Company sought approval to record the $1.2 million under recovery in the 2003 DRA and to clear the balance in the account at the end of the 2003 fiscal year along with the Company's other deferral accounts.

766

Board Findings

767

The Board finds no disagreement with the Company's proposal and notes that after the Company's clarification, there was no outstanding objection from intervenors.

768

The Board accepts the Company's proposal to record the $1.2 million under-recovery in the 2003 DRA to reflect an overall revenue deficiency of $38.2 million.

769

6.3 Service Charges

770

The Company filed a listing of service charges including changes in the level of the service charges. The revised service charges, which are mostly increases, were implemented effective October 1, 2002. These charges relate to customer support services, such as account activation and meter

unlocks; and operations services, such as work required for gas service termination, safety inspections, and meter tests.

771

The parties to the Settlement Proposal reached complete settlement on this issue, with the effect that the Company's forecast service charge revenues for the Test Year were increased from $8.8 million to $9.1 million. As part of the settlement, the parties also agreed to changing the regulatory presentation of the forecast service charge revenues from being a credit to O&M expenses to being a component of the "other operating revenue" line item in the utility operating revenue for the Test Year. The parties further agreed that the Company would provide notice to its customers of the service charges, by posting on its web site and setting out in its Rate Handbook the service charges as soon as practicable.

772

The Settlement Proposal also states that "... parties may argue and the Board may determine that service charges require Board approval. If the Board determines that service charges require Board approval, the parties agreed that, for the Test Year only, the Board should approve the service charges the Company has proposed. If necessary, Board approval of particular service charges can then occur in the Company's next rate case." (Volume 2 Appendix B, page 17)

773

The Company's Position

774

The Company submitted that Board approval of the specific level of the individual service charges is not required. The Company was of the view that the Board's rate-making powers are described in section 36 of the OEB Act and circumscribed by the wording in subsection 36(2), which provides that "the Board may make orders approving or fixing just and reasonable rates for the sale of gas by gas transmitters, gas distributors and storage companies, and for the transmission, distribution and storage of gas." In the Company's view, the OEB Act does not contemplate the Board setting rates or charges for gas services other than those listed in subsection 36(2).

775

The Company stated that the service charges are related to certain customer support and operational services and these services are provided by the Company on an as-needed, user-pay basis. The Company maintained that its service charges are cost-based and are designed to minimize the potential for cross-subsidization across customer groups.

776

The Company pointed out that the Board has not concerned itself specifically with the amount of such service charges in the past. The Board has always limited its consideration of these charges to determining whether the regulatory treatment of the revenues derived therefrom contribute to just and reasonable rates for the Company's rate-regulated activities. This is appropriate given the prescribed scope of the Board's rate-making powers.

777

Positions of the Intervenors

778

VECC's submitted that service charges do require Board approval. VECC pointed to Section 3 of the OEB Act that defines "rate" as follows:

779

> "Rate" means a rate, charge or other consideration and includes a penalty for late payment.

780

VECC was of the view that the Act has given the Board very broad powers through the definition of "rate". The service charges in question are related to the monopoly distribution of gas; and no one but distribution customers would require these services. Where charges are not specified by the Company's schedule of charges, custom quotes are required by the Company, but no competitive quotes are obtained. The charges can be substantial, especially in relation to small consumers' bill amounts.

781

VECC submitted that the inclusion of "charge" in the definition of "rate" was intended to address the Board's duties with respect to overall superintendence of rate impacts upon customers. The objective of this superintendence has been addressed in Bill 23, The Ontario Energy Board Consumer Protection and Governance Act, 2003 amending, among other things, the provisions of the OEB Act:

782

> 2. To protect the interests of consumers with respect to prices and the reliability and quality of gas services.

783

VECC submitted that it would be an exceedingly perplexing result, if the Board should exclude service charges from its regulatory purview, with the potential result of neutralizing the objective set out in Bill 23 above.

784

CAC's position is that even though specific approval of the services may not be required by the OEB Act, regulatory oversight of the charges is essential. CAC supported the concept that prior approval for changes in service charges is required. CAC submitted that this will give confidence to customers that the regulated monopoly is not charging excessive amounts for service charges.

785

CAC cautioned that although EGDI is now pricing the service charges at cost, there is no guarantee that its policy will not change.

786

CAC supported a Board policy that requires EGDI to seek prior approval for its service charges and that the schedule of service charges be subject to approval in all rate cases and included in the resulting rate orders.

787

School Boards requested that the Board comment on two matters agreed by parties in the Settlement Proposal: to change the presentation of revenue from an offset from O&M Expenses to Other Operating Revenue; and to expand the notice process for customers when service charges are changed.

788

School Boards submitted that the Board has the jurisdiction to approve, modify, or reject service charges, and that the Company is not entitled to impose any service charges that are not approved

by the Board. In School Boards' view, the Company would have unreasonable discretion to set charges within its monopoly franchise without Board approval.

789

While Schools was of the view that the Board does have the jurisdiction to regulate any individual service charges that it chooses, Schools took no position on whether the Board should regulate these charges. Schools submitted that the Board should, however, monitor these charges in annual rate cases.

790

The Company's Reply

791

In its reply argument, the Company indicated that section 36(2) of the OEB Act does not expressly or implicitly require the Board to make orders approving service charges. The Company pointed out that CAC also shared this same view.

792

While the Company did not agree that Board regulation of service charge is a requirement under the OEB Act, EGDI submitted that the evidence that it routinely files in its rates proceedings nevertheless enables the Board to monitor service charges and to determine the regulatory treatment of the revenues resulting from their implementation.

793

The Company stressed that the Board has not made it a practice to require that EGDI obtain Board approval of its service charges in the past, and EGDI saw no reason why this should change in the future. However, in the event that the Board determines that it is required to approve the service charges levied by EGDI, the Company requested the following:

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- the routine (i.e. annual) Board review of service charge not be initiated until EGDI's fiscal 2005 rate proceeding, as there is no evidence filed on this issue in EGDI's fiscal 2004 rate proceeding;

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- that EGDI continue to be permitted to implement new service charges, without obtaining Board approval, in situations that are reasonably unforeseen. In these situations, EGDI would advise the Board, by letter, of any new service charges.

796

Board Findings

797

The Board is of the view that the definition of "rate" as defined by section 3 of the OEB Act is sufficiently broad to include service charges levied by a distributor and therefore approval of service charges is under the Board's jurisdiction. This interpretation is consistent with how the Board has been regulating service charges for Union Gas Limited and for electricity distributors.

798

With regard to Union Gas the Board stated that in the RP-1999-0017 Decision, paragraph 3.107:

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> " ... However, the Board notes that under section 36 of the Act, Union must seek approval for all charges related to the transmission, distribution and storage of natural gas. Therefore the Board directs the Company to file, as part of its rate order, harmonized rates for miscellaneous charges. The Board expects Union to file supporting cost data with any application for a change to miscellaneous charges."

800

The Board observes that the service charges in question in this proceeding are not significantly different from service charges that the Board routinely reviews for electricity distributors. The Board approves service charges for electricity distributors as part of their rate proceedings and the service charges are included in electricity distributors' Board approved rate schedules under the section "Specific Service Charges".

801

The Settlement Proposal contemplates that if the Board finds that Board approval of service charges is required, then the Board should approve the Company's proposed service charges for the 2003 Test Year only.

802

As part of the Board's acceptance of the Settlement Proposal, the Board approved the Company's service charges for the 2003 Test Year. Since there was no evidence filed in EGDI's fiscal 2004 rate proceeding regarding service charges, the Board approves the continuation of the 2003 Test Year service charges for fiscal 2004.

803

The Board expects the Company to follow through with its commitment to provide customer notifications for its existing service charges.

804

The Board directs the Company to file the approved schedule of service charges with its 2005 rate application. The Board expects EGDI to file supporting cost data with any application for changes to these charges. Any changes to the service charges will be subject to the Board's normal rate change notification process.

805

The Board notes the Company's concern that it be allowed to implement new service charges, without obtaining Board approval, in situations that are reasonably unforeseen. In this regard, the Board highlights the guidelines established in the Electricity Distribution Rate Handbook that,

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> " ... Where reference to the utility being able to apply a charge or rate of any kind to a customer is made in this publication, Board approval of such a charge or rate is required, unless the charge or rate is either (i) a charge for a specific customer related to a cost recovery for the provision of one-time services, or (ii) a general customer charge that is a flow-through of third party costs". (Chapter 9, section 9.1)

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The Board directs the Company to apply the above guidelines.

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The Board finds the Company's proposed regulatory accounting presentation of service charges, as agreed to in the Settlement Proposal, acceptable.

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6.4 Information Sharing with EOS and EGS

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CEED brought forward an issue regarding EGDI's information sharing practice with its affiliates, Enbridge Operational Services Inc. ("EOS") and Enbridge Gas Services Inc. ("EGS"). EOS provides gas control, gas nominations and scheduling, and gas reconciliation services (collectively "gas control functions") to EGDI. EGS provides gas supply planning, gas acquisition, risk management, contract management, transactional and regulatory support services to EGDI.

811

CEED pointed out that in the Board's Decision under RP-2001-0032, the Board made the following statement regarding the sharing of market sensitive utility information with affiliates,

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> "It will be incumbent on ECG to establish, to the satisfaction of the Board, that it has maintained the confidentiality of information and has not provided its affiliates with information to the detriment of either ratepayers or the competitive market" (Decision, paragraph 5.11.22)

813

CEED indicated that the Company's witness confirmed in the current proceeding that a large amount of market sensitive, system-wide and aggregated customer information was provided to EGS, with no express restrictions on EGS' use of the information. CEED stated that it had requested EGDI to provide the information that the Company provided to EGS and EOS (either directly or indirectly) in the same format that it is provided to the affiliates. However, none of the information was provided to CEED members and other market participants.

814

As a result, CEED submitted that EGDI has not discharged its burden as required by the Board in paragraph 5.11.22 of the RP-2001-0032 Decision and that EGS gains a competitive advantage due to its access to EGDI's system-wide and aggregated customer-specific information that is not provided to competitors of EGS in the wholesale and retail energy services market.

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In addition, CEED was also concerned about the use of information that EOS and EGS may possess in relation to the competitive market for gas. CEED requested that the Board mandate that information acquired in the provision of utility services be used for utility services and for no other purpose.

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In summary, CEED requested that the Board:

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(a) Enforce its decision in RP-2001-0032 and require EGDI to immediately comply with its yet-to-be-met commitments regarding information sharing and outsourcing to EOS and EGS, and amend the EGS and EOS Agreements to reflect the same; and

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(b) Amend the EOS and EGS Agreements to: (i) prohibit EGD from contracting out utility services to a third party that provides competitive gas or electricity services; and (ii) require EGD to ensure that information acquired in the provision of utility services is used for utility services and for no other purpose.

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The Company's Position

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EGDI asserted that CEED's description of past events, and characterization of current circumstances, is misleading and is largely based on conjecture. The Company urged the Board to deny CEED's requested relief.

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EGDI noted that in its reply argument in the RP-2001-0032 proceeding, it provided an undertaking that it would not supply any customer-specific information to EGS beyond October 1, 2002. The Company indicated that it has met this commitment, and now only provides EGS with aggregated customer information necessary for EGS to fulfill its contractual obligations to the Company.

822

Regarding CEED's request for information provided by EGDI to EGS and EOS, the Company indicated that it had made an effort to contact CEED to clarify the request but had not received a response from CEED. In the absence of clarification, the Company merely stated its willingness to share the information in its response to the relevant interrogatory.

823

The Company pointed out that although EGDI does provide certain customer-specific information to EOS to enable EOS to provide gas control and nomination services to the Company, EOS is restricted to using that information only for providing services to EGDI.

824

The Company stated that the EOS Agreement contains safe-guards to ensure that the customer-specific information provided by EGDI to EOS is kept confidential. These provisions are filed under Exhibit I, Tab 1, Schedule 71 section 1.14. In addition, both the EOS Agreement and the Agency Agreement are subject to the provisions of the ARC. Hence EOS and EGS are obligated to "do such things as are necessary to assist [EGDI] to comply with the ARC". In EGDI's view, these provisions adequately protect the confidentiality of the information that EGDI provides to EOS and EGS, and should satisfy any concerns the Board may have in this regard.

825

The Company argued that despite CEED's repeated submissions about how EGDI's information sharing practices are a detriment to the competitive market, and presumably to CEED's members, CEED has made no attempt, in either this proceeding or in RP-2001-0032 to present evidence that demonstrates this alleged detrimental effect. In EGDI's view, the Board should therefore conclude that CEED's failure to substantiate its grievances means that they are unsupportable.

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Board Findings

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CEED had two concerns: the lack of information provided by EGDI in response to an interrogatory, and the unrestricted use of information by EOS and EGS on information obtained from EGDI.

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Regarding the first concern, the Board notes that the Company has already indicated its willingness to respond to the relevant interrogatory upon receiving clarification of the request from CEED. The Board therefore expects CEED to provide the Company with the clarification so that the Company can respond to the request. The Board expects a copy of the information provided to be filed with the Board.

829

Regarding CEED's concerns with respect to the EGS and EOS Agreements, the Board notes that the Company has provided evidence indicating it is in the process of amending both the EOS Agreement and the Agency Agreement in order to reflect safe-guards to ensure that the customer-specific information received from EGDI is kept confidential and restricted only to providing services to EGDI. The Board directs the Company to file a copy of the amended agreements with the Board and to all parties in this proceeding.

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The Board requires EGDI to ensure that information acquired by EOS and EGS in the provision of utility services is used for utility services and for no other purpose.

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6.5 HVAC Issue - Other implications of EGDI's Agreement with CWLP

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Direct Energy Marketing Limited ("Direct Energy") filed a motion with the Board on March 19, 2003 with respect to evidence filed by HVAC. In its motion, Direct Energy took the position that the evidence filed by HVAC was outside the scope of the issues list established for this proceeding. Direct Energy argued that the HVAC evidence was primarily aimed at the impact on competition in the HVAC market, resulting from the exclusive access that one HVAC company has to the Company's bill.

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On March 28, 2003, the Board issued its oral decision on the motion by Direct Energy. Some of the Board findings are recited below:

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> "The Board is of the view that the specific issue of who should have access to the Enbridge Gas Distribution bill and the impact of access to the bill in the HVAC marketplace is outside the scope of this proceeding.

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> The Board reaffirms that issue 8.3 is limited to rate consequences flowing from the arrangements between Enbridge Gas Distribution and Customer Works Limited Partnership. Therefore, the Board directs HVAC and all parties to confine their evidence and arguments so it remains within the scope of issue 8.3 as just described." (Transcript of proceedings, Volume 5, paragraph 1102 and 1103)

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<u>HVAC's Position</u>

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HVAC submitted that there were significant negative ratepayer impacts associated with EGDI's sharing of the utility bill on an exclusive basis with one non-regulated service provider for two reasons. The first is that the current and historical collection processes in place through CWLP do not give ratepayers the ability to actively understand and distinguish between regulated and unregulated charges. The second significant impact is that the collection process in place for the Company allows Direct Energy Essential Home Services ("DEEHS") to share in the Company's collection rate without the need to undertake or pay for collection efforts on its own.

838

Due to unforeseen and serious illness, HVAC's witness, Mr. Bergsma, became unavailable for cross-examination. At the hearing, HVAC submitted that Mr. Bergsma's evidence should be accepted as filed, subject to the Board giving it the weight that would be commensurate with evidence which has not been subject to verbal cross examination.

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HVAC relied on the untested evidence of Mr. Bergsma which indicated a significant level of confusion as to the relationship between the Company and DEEHS. The confusion includes a perception that the Company was endorsing the products and services of DEEHS, and that Enbridge Home Services was a part of the Company. HVAC contended that these perceptions are a direct result of the use of a regulated utility bill for the billing and collection of unregulated services, and demonstrate that ratepayers do not have a significant comprehension of the difference between regulated and unregulated charges.

840

HVAC submitted that there is a procedural cross-subsidy in the current payment allocation methodology employed by CWLP on behalf of the Company and DEEHS. HVAC contended that this cross-subsidy and the collection procedures in general have significant impacts on ratepayers and require remediation.

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HVAC suggested that the Board should consider one of a number of solutions in which to address the cross-subsidy, as well as the consumer protection issues associated with the collections practices of CWLP.

842

- Directing that EGDI file its collection procedures as part of its tariff filing, and that these practices be regulated. HVAC suggested a regulatory model similar to Chapter 56.23 of the Pennsylvania Code, which requires that amounts collected be applied to regulated charges in priority to any unregulated charges as received by a billing agent, and that prioritization be programmed in to the billing system;

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- Requiring that unregulated charges which are not associated with utility service (i.e. do not include transportation, storage, distribution or commodity) be billed and collected separately from any regulated charges;

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- Requiring that all parties making use of the EGDI bill disclose their costs to the Energy Returns Officer on a confidential basis, in order that a full audit of the reasonableness of the charges, and the reasonableness of the allocation of costs between subscribers to CWLP services be both undertaken.

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Direct Energy's Position

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Direct Energy submitted that the Board's ruling on March 28, 2003 has already excluded the evidence of Mr. Bergsma as irrelevant.

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Direct Energy argued that the only issue regarding EGDI's billing arrangements with CWLP that is relevant to this proceeding is ratepayer impact. In particular, who has access to the bill and any competitive impact of that access are matters clearly beyond the scope of this Board's inquiry.

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Direct Energy addressed two legitimate issues concerning ratepayer impact of the shared bill:

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- whether ratepayer costs are impacted by EGDI sharing the bill with Direct Energy; and

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- whether ratepayers are somehow prejudiced by CWLP's allocation of partial payments.

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With regard to the first issue, Direct Energy submitted that there is uncontradicted evidence that EGDI saves approximately $5 million annually by sharing its bill with Direct Energy. Direct Energy submitted that the $5 million saving is realized by CWLP splitting variable production costs (including stationery, bill printing, inserting, payment processing and postage) in a fair apportionment (i.e. "50/50") between EGDI and Direct Energy.

852

Direct Energy stated that the only suggestion in the evidence that EGDI incurred any cost associated with this saving is that, in partial payment situations, CWLP's application of the amounts received, on a pro rata basis according to respective aged receivables, may have cost the Company up to $300,000 per annum. However, the Company's witness Mr. McGill indicated that since controls were introduced into the system in May 2003, there is no longer potential for such a deduction to the Company's savings.

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Direct Energy submitted that irrespective of whether the Board applies the "ratepayer held harmless" or the more demanding "ratepayer benefit" standard in assessing the legitimacy of EGDI sharing its bill with Direct Energy, there can be no issue to concern the Board. The conclusion is that there is significant net financial benefit to ratepayers of $4,700,000 annually at a minimum.

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The Company's Position

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The Company did not respond to the arguments on this issue.

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Board Findings

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The Board notes that its decision on March 28, 2003 reaffirms that issue 8.3 is limited to rate consequences flowing from the arrangements between EGDI and CWLP.

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In the Board's view, HVAC has not provided evidence indicating that ratepayers' costs have been adversely affected due to EGDI sharing the bill with DEEHS. On the contrary, the Company's evidence appears to demonstrate significant savings as a result of this arrangement.

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Regarding the issue of potential cross-subsidy associated with the collection practices of CWLP using an allocation methodology for partial payments, the Board is of the view that HVAC has not provided evidence to substantiate the magnitude of the potential cross-subsidy. Based on the evidence presented by the Company, the historic net impact of this allocation practice may have cost the Company approximately $300,000 on an annual basis. The Company also indicated that the impact going forward would be further mitigated by the introduction of more controls into the billing system.

860

The Board finds that the evidence presented and tested in this proceeding is not sufficient to allow it to conclude that there are significant negative ratepayer consequences on EGDI's current bill sharing arrangement with DEEHS nor does it provide the Board with sufficient justification to impose the three changes proposed by HVAC.

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6.6 Rate Retroactivity

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In the Settlement Proposal, parties agreed to make submissions in argument under issue 13.1 to address how rate retroactivity ought to be minimized in the future. IGUA, Schools and School Boards made submissions on this issue.

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IGUA submitted that applications to the Board for rate relief need to be managed in an orderly way and within a time period that is commensurate with the scope and complexity of the issues raised therein. Generally speaking, IGUA was of the view that Board Orders ought not to be retroactive in their effect. However, every applicant must lead sufficient evidence to satisfy the Board that the relief it seeks is just and reasonable. The Board should never sacrifice careful scrutiny of an application for the sake of expediency. Care ought to be taken to ensure that the current hypersensitivity to rate retroactivity does not induce the Board to sacrifice thorough scrutiny of an application in order to achieve an expedient disposition of the matter.

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Schools was of the view that the Company is addressing the retroactivity issue through its accelerated 2004 rates submission. Schools agreed with that approach and noted that all parties accepted the importance of avoiding retroactive rate applications.

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School Boards did not consider it necessary at this point to make any submissions on rate retroactivity because of the implications of Bill 23 and EGDI's response to retroactivity through the 2004 application process.

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Board Comments

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The Board notes that the Company's rates for 2003 were implemented on May 1, 2003, 8 months into the fiscal year. The Board stresses that the issue of rate retroactivity will be an ongoing concern of this Board.

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The Board also notes that EGDI filed a special rates application in 2004 to get "back on track". The 2004 rates were implemented before the start of the fiscal year on an interim basis.

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The onus is now on the Company to stay on track. As agreed in the partial settlement proposal, the Company intends to file its 2005 application with full cost-of-service evidence, including a historical year, bridge year, and test year. The Board expects the Company to consult the Board and stakeholders on the schedule for the filing of its 2005 application to ensure that rates are implemented in advance of the 2005 test year.

7 DISCLOSURE AND CONFIDENTIALITY

7.1 Background

Disclosure and confidentiality became significant issues in the course of the hearing. During the interrogatory process, a number of parties had requested information relating to the issue of affiliate outsourcing and efficiency gains. EGDI did not answer a number of these interrogatories, on the basis that the information requested was in the possession of affiliates over which EGDI had no control. The Board's rules of practice provide a mechanism to be used by parties who seek information that is not forthcoming during the interrogatory process. However, the parties in question did not pursue this issue until the hearing was underway.

On March 27, 2003 CAC, IGUA and VECC filed a motion requesting the disclosure of documents by EGDI and its affiliates. The motion was argued on April 8 and 9, 2003 and the Board issued its decision on April 15, 2003. In that decision, at paragraph 4.8, the Board stated:

> The Board's focus is with respect to what constitutes just and reasonable rates and in that context, the Board wants to understand:
>
> - the basis upon which the decision to outsource was made,
> - whether the cost is a market-based price and if so what market-based process was used to select the service provider, and
> - where there is no market for the outsourced service, what is the cost to the service provider to provide that service to the utility.
>
> To the extent that documents not yet filed in this proceeding, and in the hands of EGDI, EI, EOS, ECS, EGS, or CWLP, meet these criteria and are relevant and material to determining:
>
> > the amount, if any, by which the O&M expenses envelope of $270 million is to be reduced to reflect the efficiency gains which intervenors say were transferred by Enbridge Gas Distribution to affiliates and then, in part, to a related party between October 1, 1999 and September 30, 2002, being the term of the Board approved targeted performance based regulation ("TPBR") plan, [from the Settlement Agreement, Ex.N1/Tab 1/ Schedule 1, page 36]
>
> the Board requires them to be produced to the moving parties.

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Recognizing that some of the documents to be disclosed might contain commercially sensitive information, the Board established a procedure to deal with the issue of confidentiality. If a producing party had a confidentiality concern with respect to any documents being produced, those documents were to be produced on a confidential basis to the other parties. As required, the parties met to discuss confidentiality issues. At the conclusion of that meeting, parties still had a concern about the adequacy of the disclosure and the issue was brought back to the Board on April 29, 2003. The Board rendered a second disclosure decision orally on May 1, 2003.

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CWLP, EI, ECSI, EOS, and EGS then sought to appeal the Board's disclosure decisions to Divisional Court, challenging the Board's jurisdiction to require the production of documents from non-parties.

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On May 13, 2003 the Board issued summonses requiring a representative of EI and a representative of CustomerWorks Inc. ("CWI") to attend the hearing and to bring with them the documents that were the subject of the disclosure decisions. The summonses were withdrawn after the producing parties agreed to produce the required documents to the Board on a confidential basis. The producing parties made submissions to the Board on May 19, 2003 requesting that the documents be handled in the hearing on a confidential basis. They also requested that when those documents were the subject of testimony, that those portions of the hearing be held in camera. The Board ruled that the documents would be handled on a confidential basis. Given the large number of documents to be handled confidentially, the Board decided that the hearing would be closed to the public while those documents were being discussed.

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The Board directed the producing parties to meet with Board Counsel to review the transcripts from the in camera sessions to discuss which portions of the transcripts actually needed to be kept confidential. As a result of those meetings, the parties were able to agree that only relatively short portions of the transcripts needed to be kept confidential. These redacted transcripts were then placed on the public record. A similar process is being followed for undertaking responses and the written arguments of parties as they pertain to confidential evidence.

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7.2 Board Findings

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The refusal by EGDI and its affiliates to produce relevant information in response to interrogatories, coupled with the delay by the intervenors in bringing this disclosure issue to the Board, put the Board in a difficult position. On the one hand, there was the need to address the legitimate problem of non-disclosure of relevant information. Disclosure is a critical part of the Board's process. That is why the Board has an interrogatory process. On the other hand, there was the need to complete the hearing process in a timely fashion, given the Board's crowded regulatory agenda. While the Board's approach to the problem was a pragmatic one under the circumstances, it was not ideal. Section 9 of the Statutory Powers and Procedures Act (“SPPA”) provides that hearings are to be public unless the tribunal is of the opinion that:

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> intimate financial or personal matters or other matters may be disclosed at the hearing of such a nature, having regard to the circumstances, that the desirability of avoiding disclo-

> sure thereof in the interests of any person affected or in the public interest outweighs the desirability of adhering to the principle that hearings be open to the public.

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The Board's process would have been better served if it had been afforded more time to address the issue of confidentiality.

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While the Board recognizes that EGDI's refusal to produce relevant information was based in part on the fact that the information was in the hands of affiliates, the Board must point out that EGDI along with its affiliates and EI, its parent, have adopted a common management approach that is based on the concept of "one company, one vision", as it is described in company documents. EGDI bears the burden of proof to establish that the rates it is requesting are just and reasonable. In the absence of relevant information sufficient to discharge this burden, it is always open to the Board to turn down a rates application or disallow specific costs that the applicant seeks to recover in rates. However, the Board is charged with determining just and reasonable rates and is required to act in the public interest, in a balanced and fair manner. To be able to do this properly, the Board requires sufficient information about all of the costs that EGDI seeks to recover in rates.

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The disclosure issue first arose in the RP-2001-0032 proceeding. During the course of that proceeding, EGDI was asked to canvas its affiliates with respect to their willingness to disclose information in their possession related to the costs incurred to provide services to EGDI. EGDI reported back that the affiliates declined to produce such information. In its decision, the Board stated, at paragraph 5.11.25:

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

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> At paragraph 6.2.14, the Board stated:

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

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> and at paragraph 6.2.21:

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> The Board has always relied on the good faith of the utilities in making timely, complete and accurate disclosure of all information relevant to the operations of the utility, whether or not the specific information has a direct impact on the Board's rate-making function. If

> this is no longer the case, the Board will have no alternative but to consider other regulatory tools available to it, such as: including conditions regarding disclosure in orders, requiring the preparation of evidence pursuant to subsection 21(1) of the Act, and making rules pursuant to paragraphs 44(1)(f)or(g) of the Act.

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Notwithstanding this, in the present proceeding, EGDI and its affiliates chose not to disclose relevant information during the course of interrogatory process, and resisted the Board's direction to produce that information until the Board issued summonses.

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As a result of its experience with the issues of disclosure and confidentiality in this proceeding, the Board has reached the following conclusions.

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First, the Board's process is not served well by having to issue summonses to obtain evidence that should be made available during the interrogatory process. The Board's discovery process should be completed well in advance of the commencement of the oral hearing and any disclosure issues that arise during the discovery stage should be brought to the Board as early as possible if they cannot be resolved amongst the parties. The Board expects intervenors to raise disclosure issues as early as possible and to avoid waiting until the oral proceeding begins and to make timely use of the procedures for compelling disclosure that are provided for in the Board's rules of practice.

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Secondly, given that EGDI and its affiliates operate on a shared management philosophy, it is inappropriate for EGDI and its affiliates to refuse to disclose information simply on the basis that EGDI, as the applicant, has no control over information in the possession of affiliates. The fact that EGDI chooses to outsource various functions to its affiliates does not mean that the cost to provide those functions is no longer within the purview of the Board's jurisdiction. Therefore, the Board requires EGDI to inform all affiliates of their responsibility to provide relevant information required by the Board to carry out its statutory mandate.

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Thirdly, the Board expects that any confidentiality issues arising out of the disclosure process will be dealt with well in advance of the commencement of any oral proceeding. If EGDI or any of its affiliates wish to claim confidentiality in relation to a particular document, the Board expects the document to be carefully reviewed to minimize the amount of redaction requested. The treatment of evidence on a confidential basis not only creates significant logistical difficulties but also curtails the public’s ability to observe and participate in the Board's proceedings.

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8 COST AWARDS

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This proceeding was long and involved many issues, including several that had accumulated from prior applications.

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The proceeding involved a full cost-of service application, linked to an analysis of a substantial corporate restructuring by Enbridge Inc., the shareholder of the utility, and several of its affiliates. It included the first major review of the Demand Side Management program of the Company since its inception and the settlement of historic incentive payments associated with that program. It required an unusually long ADR aimed at settling or at least narrowing of the issues. It consumed twenty-nine days of hearings, plus an additional two hearing days to deal with the approval of the Issues List and the presentation of the Partial Settlement Proposal. It required the specific handling of: several motions and the hearing of submissions related to those motions; separate submissions followed by oral decisions related to urgent application features identified by the applicant; receipt and processing of confidential filings; several hearing days involving "in camera" proceedings; extraordinary measures to protect confidentiality and sensitivity; and, substantial arguments and an early decision on the DSM issues.

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Not surprisingly, the Board received extensive cost award claims from 13 claimants, including Associated Toronto Taxicab Co-operative, Canadian Natural Gas Vehicle Alliance, CEED, CME, CAC, Energy Probe, GEC, HVAC, IGUA, Pollution Probe, School Boards, Schools and VECC.

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The Board notes that there were no submissions received from the Company with respect to the claims outlined above.

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Cost eligibility and claims have been considered under the Board's guidelines existing prior to February 21, 2003, the date upon which the Board issued its new Practice Direction - Cost Awards. This rate application was filed with the Board prior to the Board's new guidelines and the claimants listed above have been treated in accordance with the earlier guidelines.

907

The Board has reviewed all of the submissions including the supporting documentation.

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The Board was greatly assisted by the contributions of all of the parties to this hearing and is generally satisfied with the level of cost awards requested. However, the Board has specific concerns with the costs requested by School Boards when compared to other intervenors.

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School Boards' claim contains requests for legal hours and total hours which exceed all other parties. Furthermore, School Boards total dollars claimed was also the highest claim, when the cost claimed by expert witnesses was subtracted from the others.

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While the Board appreciates the contributions of School Boards, the Board finds that the School Boards' legal and consultant claim shall be reduced by 20% to make it more appropriate relative to the other parties, based upon level of contribution and associated cost expectations.

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The Board therefore directs the Board's Cost Assessment Officer to review the costs claimed in order to make adjustments as necessary to ensure that they are consistent with the Board's Cost Assessment Guidelines in effect at the time the application was filed.

912

The Board received a submission from CAC on October 15, 2003, requesting interim payment on claim amounts as a result of the length of time from the commencement of this application to its completion. While the Board is sympathetic to this issue, the Board finds that little will be gained by an interim payment versus the expeditious processing of the Board's cost awards finding contained herein.

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

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The Board's costs of, and incidental to, this proceeding shall also be paid by EGDI upon receipt of the Board's invoice.

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DATED at Toronto, November 7, 2003

Bob Betts
Presiding Member

George A. Dominy
Member