

*Case Name:*  
**Union Gas Ltd. (Re)**

**IN THE MATTER OF the Ontario Energy Board Act, 1998,  
S.O. 1998, c. 15, Sched. B;  
AND IN THE MATTER OF an Application by  
Union Gas Limited for an order or  
orders approving or fixing just and reasonable  
rates and other charges for  
the sale, distribution, transmission,  
and storage of gas for periods  
commencing January 1, 2001, and January 1, 2002;  
AND IN THE MATTER OF the customer review  
process and other mechanisms  
approved by the Ontario Energy Board  
in its decision in RP-1999-0017.**

2002 LNONOEB 5

No. RP-2001-0029

Ontario Energy Board

**Panel: Malcolm Jackson, Presiding Member;  
George A. Dominy, Member; Paul B.  
Sommerville, Member**

Decision: September 20, 2002.

(535 paras.)

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**DECISION WITH REASONS**

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## **1. THE APPLICATION AND THE PROCEEDING**

### **1.1 THE APPLICATION AND BACKGROUND**

**1** 1.1 Union Gas Limited ("Union") filed an application dated July 30, 2001 (the "Application"), with the Ontario Energy Board (the "Board") pursuant to section 36 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sched. B (the "Act"), for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas, effective for the years commencing January 1, 2001, and January 1, 2002 (the "Application"). The Board assigned file number RP-2001-0029 to the Application and the consequent proceeding ("RP-2001-0029").

**2** 1.2 The current application arises under a Performance Based Regulation ("PBR") methodology for setting rates proposed by Union and approved by the Board in its Decision with Reasons issued July 21, 2001, in the Board's proceeding numbered RP-1999-0017, 2001 LNONOEB 3 ("RP-1999-0017"). In the RP-1999-0017 Decision the Board approved rates for 2000 based on adjusted 1999 data. For a trial PBR term of three years the Board adopted a methodology under which rates would be changed for years commencing January 1, 2001, 2002, and 2003 by using a price cap index ("PCI") determined by an inflation factor ("I") a productivity factor ("X") and certain pass-through adjustments and non-routine adjustments. Pass-through items are relatively routine, predefined and beyond management's ability to control. Non-routine adjustments are unusual and unexpected, beyond management's ability to control.

**3** 1.3 The parameters defining the annual price index, its calculation, the cost pass-throughs, and any other adjustments including those associated with disposition of any deferral account balances,

were to be reviewed by Union and its stakeholders through a Customer Review Process ("CRP") and adjustments then brought before the Board for approval.

**4** 1.4 Union proposed an annual process to consult with intervenors and review the adjustments required for setting rates in each subsequent year of its PBR plan. The Board, in RP-1999-0017, endorsed the process and set out certain features which should form part of an annual CRP. The Board has continued to view the CRP as a vehicle to disseminate information to stakeholders and to seek acceptance and consensus where possible. In its view, a healthy CRP with sufficiently knowledgeable and informed parties may reduce the need for intervention by the regulator and permit lighter-handed regulation.

**5** 1.5 Union intended to provide intervenors in June of each year with information and its proposals for pass through adjustments, certain non-routine adjustments, forecast balances in the deferral accounts and their disposition, a report on Union's system quality indicators ("SQI") performance and actual financial results for the previous year.

**6** 1.6 The Board, in RP-1999-0017, also noted that since it was introducing a new regulatory framework, the filing requirements needed to be defined. Accordingly, the Board prescribed information required to evaluate and administer the PBR plan. Union is expected to file, among other things, information on revenue-to-cost ratios for rate classes, financial information segregated by line of business and information necessary to establish the threshold for the earnings sharing mechanism ("ESM"). For the most part, this is information which Union has filed previously in rate proceedings, or quarterly with the Energy Returns Officer of the Board. The Board expected the level of detail, and any new format for filing this information, to be arrived at through discussions with Board staff and reviewed when necessary or convenient by the Board. Union was also required to continue providing information through the DSM consultative and information as established in respect of Board's Decision, EBO 188, issued January 30, 1998, which addressed system expansion.

**7** 1.7 The Board in its Decision with Reasons in RP-1999-0017, para. 2.772, identified the steps required of the CRP as follows:

- \* Union would provide an information package in late June which would include proposals for non-routine adjustments, potential gas cost changes, actual and forecast deferral account balances and proposed disposition, information on the prior year's financial performance, information for the calculation of earnings sharing, revenue-to-cost ratios, pass-through items and an SQI performance report;
- \* Union would file information on new regulated services and services under negotiated prices;

- \* Union would attempt to seek consensus with parties in July and then file a report with the Board in early August identifying the consensus achieved and stakeholder positions on the outstanding issues;
- \* a Board decision on the issues would be issued. Union would then file an October package incorporating the Board's findings and provide further detail in respect of the deferral account balances and show that the proposed rates are consistent with the PBR plan;
- \* stakeholders would have an opportunity to review and make submissions on the rate package; and

\* the Board would then approve a new rate order.

**8** 1.8 In fact, the steps in the first CRP occurred differently. Union did not file an application with the Board until July 30, 2001, accompanied by limited pre-filed evidence. Union noted that it would take some time to prepare all of the material required for the CRP. The balance of the material was filed with the Board on December 3, 2001.

**9** 1.9 The Board recognizes that the delay in issuing the Decision in RP-1999-0017 until July 21, 2001, significantly delayed the start of the CRP. However, apart from the issue of timing, the Board is concerned that Union appears not to have consulted effectively with stakeholders until the commencement of the settlement conference (the "Conference") at the Board on March 5, 2002. The Board expects Union to follow the spirit and intent of the stakeholder consultation which was expected to be an integral part of Union's CRP.

**10** 1.10 The parties identified twenty categories of issues which required resolution. They are set out in the Settlement Agreement, attached as Appendix A of this decision. Stakeholders agreed on proposals for the resolution of many outstanding matters.

**11** 1.11 On one of the settled matters, the late payment penalty provision, the Board indicated its decision for a slightly modified provision. At the commencement of the oral hearing, parties to the settlement proposal, did not request any consequent changes to other proposals which had been agreed upon. With that modification, the Board accepted the Settlement Agreement on April 5, 2002.

**12** 1.12 The remaining matters were examined in the oral hearing. During the oral hearing the Board raised concerns about the financial information which was filed in compliance with financial information required for 2001 and which was subsequently filed pursuant to the Settlement Agreement. The adequacy and appropriate definition of utility and non-utility transactions became

an issue during the proceeding.

## **1.2 AMENDMENTS TO THE APPLICATION**

**13** 1.13 In the Application, Union sought revisions to the methodology for weather normalization and revisions to the Board-approved formula for determining Union's return on equity, both of which, if approved, would form the basis for corresponding non-routine cost adjustments to be recovered in rates.

**14** 1.14 Union amended its application in respect of weather normalization to seek the Board's approval for use of the new methodology in planning and operations, but withdrew its request for a non-routine adjustment to rates for 2001 and 2002. The implications of the new weather normalization methodology are addressed in section 5.2

**15** 1.15 In the pre-filed evidence accompanying its Application of July 31, 2001, Union requested a change to the formula used by the Board to establish the allowed return on equity ("ROE"). Pre-filed evidence prepared by Ms. Kathleen McShane of Foster Associates, Inc. accompanied the Application. Mr. Penny, Union's counsel wrote to the Board on September 5, 2001, indicating that it was Union's position that any revisions to the ROE formula would give rise to a non-routine adjustment. Mr. Penny, also indicated that "Union would be willing to consider a generic proceeding for ROE as an appropriate way to review the issue provided that a generic proceeding would still yield a result that would be applied to Union with effect from January 1, 2002."

**16** 1.16 In November 2001, Union amended its position, withdrawing its request for a non-routine adjustment in 2001 and 2002 for any change in ROE, but retaining its request that proposed revisions to the ROE formula be used to establish the thresholds for the Earnings Sharing Mechanism ("ESM") for 2002. Union urged the Board to deal with this issue expeditiously.

**17** 1.17 The ROE issue will be addressed by the Board in another proceeding, as yet undetermined. ROE in the context of the ESM is addressed in section 6.2.

## **1.3 THE PROCEEDING**

**18** 1.18 On December 14, 2001, the Board issued Procedural Order No. 1 and sent it to the intervenors and observers of record in RP-1999-0017. Procedural Order No. 1 provided that consideration of Union's proposed revisions to the Board-approved return on equity formula be deferred to a separate proceeding. It also established: a schedule for the filing of interrogatories by parties and their responses; March 5 to 8 as dates for holding the alternative dispute resolution ("ADR") Conference at the Board's offices in Toronto; and March 21, 2002, as the date by which the report of the Conference should be filed with the Board.

**19** 1.19 On February 7, 2002, the Board in Procedural Order No. 2 required that consideration of the incremental unbundling costs ("IUC") deferral account be dealt with in RP-2000-0078, 2002

LNONOEB 6, a proceeding to enable the unbundling of services and rates for small volume customers on the Union system ("RP-2000-0078"). Specifically, the Board required that this proceeding be combined with RP-2000-0078, to the extent necessary to hear in the RP-2000-0078 proceeding IUC issues originally intended to be resolved in this proceeding.

**20** 1.20 The Conference Report entitled "RP-2001-0029 Union Gas Settlement Agreement" dated March 22, 2002 was filed with the Board. Procedural Order No. 3 was issued March 30, 2002, setting April 4, 2002, as the date for the Board to seek clarification of the Conference Report, as necessary, and then to commence the oral hearing of outstanding issues. The Conference Report contained a settlement proposal on issues agreed to by parties and a status report on issues addressed but unresolved.

**21** 1.21 The oral hearing of the unresolved issues commenced on April 4, 2002, and continued until Monday April 15, 2002. At the commencement of the oral hearing, Union presented and elaborated on the Conference Report and responded to questions of the Board panel. Union's argument-in-chief was presented orally on April 17, 2002. Reply arguments were due to be filed by intervenors by May 3, 2002, and Union's reply argument by May 14, 2002. Arguments of several intervenors were delayed a few days and Union subsequently requested, and the Board granted, an extension until May 21, 2002, to submit Union's reply argument.

#### **1.4 THE SETTLEMENT CONFERENCE**

**22** 1.22 The Board's Rules of Practice and Procedure make provision for the holding of a settlement conference. The Board recognizes that settlement conferences have become an integral part of natural gas rates applications and that parties commit significant resources in terms of personnel and time to achieving agreement. Through an ADR process, parties are often able to resolve issues through negotiation, resulting in cost effective solutions and a more focussed and efficient regulatory process.

**23** 1.23 The Board acknowledges the efforts of the parties and the Board-appointed facilitator, Mr. Dennis O'Leary, in achieving agreement on a number of issues. However, the Board is concerned with the wording in the preamble to the Proposed Settlement Agreement which states that:

It is acknowledged and agreed that this Agreement will be null and void if the Board does not, prior to the commencement of the hearing of the evidence in RP-2001-0029, accept the Agreement in its entirety.

**24** 1.24 At the commencement of the oral hearing in RP-2001-0029, following questions from the Board and answers to explain the Conference Report, Union's counsel specifically raised this provision and stated that in his view there would be a problem if the Board were to commence the hearing of any evidence on unresolved matters prior to accepting the Settlement Agreement in its entirety.

**25** 1.25 The Board understands that certain compromises may be made by parties to achieve an agreement. However, the Board observes that an ADR process is not a substitute for the Board's deliberations on any given issue following the testing of evidence in a hearing. On certain issues the Board may find the settlement to be less than acceptable. In such circumstances the Board will not hesitate to reject the settlement of such an issue, regardless of the impact this may have upon the parties' willingness to continue supporting the balance of the agreement. Nor should the Board's acceptance of a settlement agreement be considered as a specific approval of each element of an approved settlement agreement.

**26** 1.26 The Board understands the desire of parties to have the settlement agreement accepted in total and that, as such, if one aspect is not adopted by the Board, parties agree that the agreement becomes null and void. Yet, for time efficiency or other considerations, such as scheduling, in other cases the Board has been able, without objection of the parties, to commence hearing some unresolved matters while it considers whether it is prepared to accept the settlement agreement in its totality. The time between receipt of a settlement proposal and the scheduled commencement of the oral hearing can become compressed beyond what was scheduled and what is desirable. If the Board has sought clarification on the agreement it may then require time to consider the agreement in light of its new understanding.

**27** 1.27 This flexibility and efficiency is lost, or perhaps the value of having crafted an agreement may be lost, if the provision requiring Board acceptance prior to the hearing of any evidence is imposed.

**28** 1.28 While a settlement proposal may be framed as a settlement "agreement", in fact it is an agreement among the applicant and intervenors, to make a proposal to the Board as to the terms and conditions that would be acceptable to the parties. Indeed the settlement proposal also establishes where the parties have not been able to reach agreement on what should be proposed to the Board. However, the settlement proposal is just that - a proposal - and is not binding on the Board. It is incumbent on the Board, indeed it is the statutory duty of the Board, to ensure that rates are just and reasonable. Time to deliberate to accomplish this should not be truncated; it must be taken.

**29** 1.29 On April 4, 2002, the Board heard oral submissions in clarification and explanation of the settlement proposal of the parties. On April 5, 2002, the Board, in accepting the Settlement Agreement, stated that it was "prepared to go forward on a fairly safe basis and to accept the proposed settlement as agreed to by the parties as the basis for our decision on those matters on which there has been settlement."

## **1.5 PARTICIPANTS AND THEIR REPRESENTATIVES**

**30** 1.30 The Board received a request for late intervenor status on behalf of the Ontario Flue-Cured Tobacco Growers Marketing Board ("Tobacco Growers"), at the time of the Conference. Union raised no objection and the Tobacco Growers participated in the Conference. The Tobacco Growers, however, did not participate actively in the hearing process which followed.



**31** 1.31 Below is a list of participants and their representatives that participated actively, through leading evidence or cross-examining at the oral hearing, or by filing argument.

**Union Gas Limited**

**Michael Penny  
Marcel Reghelini  
Thomas Byng**

**Board Counsel and Staff**

**Pat Moran  
Chris Mackie  
James Wightman**

**Canadian Manufacturers & Exporters Inc. (“CME”)**

**Malcolm Rowan  
Tom Moutsatsos**

Coalition for Efficient Energy Distribution (“CEED”)	George Vegh Elisabeth DeMarco
Consumers’ Association of Canada (“CAC”)	Robert Warren
The Convergence Group (“TCG”)	George Vegh
The Corporation of the City of Kitchener (“Kitchener”)	Alick Ryder Dwayne Quinn
Direct Energy Marketing Limited (“Direct Energy”)	David Brown
Enbridge Gas Distribution Inc., formerly The Consumers’ Gas Company Ltd. (“EGDI”)	Jerry Farrell Barbara Bodnar Robert Rowe
Green Energy Coalition (“GEC”)	David Poch
The Heating, Ventilation, Air Conditioning Contractors Coalition Inc. (“HVAC Coalition”)	Ian Mondrow
Hydro One Networks Inc. (“HONT”)	Glen MacDonald
Industrial Gas Users Association (“IGUA”)	Peter Thompson Vince DeRose
London Property Management Association (“LPMA”)	Randy Aiken
Ontario Association of Physical Plant Administrators (“OAPPA”)	Valerie Young
Ontario Association of School Business Officials (“Schools”)	Thomas Brett
Pollution Probe	Murray Klippenstein
TransCanada PipeLines Limited (“TCPL”)	Tibor Haynal
Vulnerable Energy Consumers’ Coalition (“VECC”)	Michael Janigan
Wholesale Gas Purchasers Service Group (“WGPSG”)	Richard King Aaron Detlor Randy Aiken

**32** 1.32 Others that commented on or observed this proceeding were:

Meritor Suspension	letter dated April 4, 2002
Ontario Flue-Cured Tobacco Growers Marketing Board	participant in Conference
Oxford Automotive (“Oxford”)	letter dated March 12, 2002
P. Barnett Construction Inc. (“Barnett”)	letter dated April 3, 2002

#### **1.6 WITNESSES**

**33** 1.33 The following Union employees appeared as witnesses:

Steve Baker	Vice-President, Gas Supply Services
John Bremner	Director, Asset Acquisitions
David Dent	Long Term Gas Supply Manager
Patricia Elliott	Controller
Ken Horner	Manager, Revenue and Gas Accounting
Michael Packer	Manager, Rates and Pricing
Helen Platis	Market Planning and Evaluation
Dave Simpson	Manager, Asset Acquisition

**34** 1.34 In addition, Union called the following witnesses:

Ross Hemphill	Vice-President Laurits R. Christiansen Associates, Inc.
Philip Schoech	Vice-President Laurits R. Christiansen Associates, Inc.
Jack Mintz	Professor, School of Management University of Toronto
Thomas Wilson	Institute of Policy Analysis University of Toronto

**35** 1.35 GEC called the following witness:

Chris Neme	Vermont Energy Investment Corporation
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**36** 1.36 Pollution Probe called the following witness:

Jack Gibbons	Public Interest Economics
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**37** 1.37 Evidence pre-filed by parties, which addressed matters resolved through the Conference and not attested to orally, was adopted and supported by affidavits of those parties.

### **1.7 SUBMISSIONS AND EXHIBITS**

**38** 1.38 Copies of the evidence, exhibits, arguments, and a transcript of the proceeding are available for review at the Board's offices. A copy of the Conference Report dated March 22, 2002, is provided in Appendix A to this decision. A list of abbreviations used in this Decision is provided in Appendix B.

**39** 1.39 The Board has considered the evidence, submissions and arguments in the proceeding, but has summarized the evidence and the positions of the parties only to the extent necessary to provide context for its findings.

**40** 1.40 The Board, with industry participation, has developed standards and processes for the electronic regulatory filing ("ERF") of evidence, submissions of parties, Board orders and decisions. This Decision with Reasons will be available in ERF form shortly after initial copies are issued in hard copy. The ERF version will have the same text and numbered headings as the initial hard copy, but may be formatted differently.

## **2. DEFERRAL ACCOUNT RELATED ISSUES**

### **2.1 ALLIANCE VECTOR TRANSPORTATION CONTRACTS**

#### ***Background***

**41** 2.1 Union applied to the Board in August, 2001, for approval of the implementation of a "vertical slice" methodology for determining the allocation of Union's upstream transportation portfolio, including contracts with Alliance Pipelines ("Alliance") and Vector Pipelines ("Vector"), to customers opting for direct purchase instead of system gas. The proceeding is known by its file number ("EB-2001-0441", 2001 LNONOEB 4) or as the Vertical Slice case.

**42** 2.2 In its Decision with Reasons in this matter, dated September 6, 2001, the Board approved the inclusion of the Alliance and Vector contracts in the November 2001 vertical slice to be used by Union in assigning upstream transportation to system customers that transfer to direct purchase, but did not make a finding on the prudence of the contracts. The Board directed Union to "... maintain records sufficient to enable the Board to make any necessary adjustments to affected customers to reflect the cost consequences of any subsequent finding of the Board regarding the prudence of these contracts and, hence, the reasonableness of the costs which flow from them." The issues of prudence and the cost consequences were deferred to the present application. A deferral account was established to record the net cost difference between the Alliance Vector tolls and the TCPL tolls for firm service for volumes arriving at Dawn.

**43** 2.3 Union chose not to file new evidence in this proceeding, but relied on the evidence it had previously filed in the Vertical Slice case as well as the viva voce evidence.

**44** 2.4 Union's evidence is that the Alliance project was completed in 2000 and gas deliveries commenced in November 2001. The pipeline is approximately 1900 miles in length and has a capacity to transport 1.0 Bcf/d from the gas producing regions of British Columbia and Alberta to the Chicago hub. The Vector pipeline is approximately 340 miles in length and is capable of transporting 1.0 Bcf/d from the Chicago hub to Union's compressor station in Dawn Ontario.

**45** 2.5 Union contracted for a 15 year term for daily transport of 80 MMcf/d on the Alliance pipeline in 1997 and correspondingly, 84,400 GJ/d (80 MMcf/d at 1.055 GJ/Mcf), on the Vector pipeline in 2000. The tolls are established by the Federal Energy Regulatory Commission ("FERC") and the National Energy Board (the "NEB"). The higher energy content of the gas shipped on the Alliance system effectively increases the natural gas received at Chicago by an additional 6,854

GJ/d (6.5 MMcf/d). Further, Union's contracts with Alliance allow it to ship an additional 13,505 GJ/d (12.8 MMcf/d) without incurring additional demand charges as Authorized Overrun Service. Union's evidence is that both of the factors together effectively reduce the tolls for energy shipped on the Alliance and Vector systems, and thereby reduce the excess of such tolls over the corresponding TCPL tolls.

**46** 2.6 The price of the gas transported to Union through the Alliance and Vector pipelines ("Alliance Vector") has been such that the deferral account designed to capture the disparity between the contractual price of the Alliance Vector gas delivered to Union and the prevailing landed price for gas delivered to Union through the TCPL system has accumulated a debit balance amounting to \$17.18 million.

**47** 2.7 Union submitted that in determining prudence the Board should adopt the guidelines developed by the National Regulatory Research Institute ("NRRI"). Those guidelines contain the following principles:

- \* first, there should exist a presumption that the investment decisions of the utilities are prudent. The presumption of prudence can be overcome, however, by an allegation of imprudence that is backed up by substantive evidence creating a serious question about the prudence of the investment decision. Once the presumption of prudence is displaced, a regulator needs to decide on the legal standard for judging prudence;
- \* second, the regulator should use a standard of reasonableness in assessing prudence. This means that to be prudent, a utility decision must have been reasonable under the circumstances that were known or could have been known at the time the decision was made;
- \* third, a corollary to the standard of reasonableness, under the circumstances is a proscription against the use of hindsight in determining prudence;
- \* fourth, prudence should be determined in a retrospective, factual inquiry. The evidence needs to be retrospective in that it must be concerned with the time at which the decision at issue was made. Testimony must present facts, not merely opinion, about the elements that did or could have entered into the decision at the time.

### ***Intervenors' Positions***

**48** 2.8 CAC presented a detailed argument on the prudence of the Alliance and Vector contracts. It reviewed the four criteria that Union proposed should be adopted by the Board in assessing prudence. It argued that under the Act the onus is on Union to demonstrate that the rates it proposes are just and reasonable and that there is no burden on intervenors to prove the contrary. CAC stated:

"One of the fundamental, structural weaknesses in the regulatory process is the gross disparity in the information available to the utilities, on the one hand, and to the intervenors, on the other. Access by the intervenors to meaningful information is entirely dependent upon the accident of asking the right question in a written interrogatory or in cross-examination."

**49** 2.9 CAC claimed that the application of the guidelines which Union put forward make it effectively impossible for intervenors to challenge the prudence of Union's decision to contract for Alliance and Vector transportation capacity. It argued that the onus should be on Union to lead evidence showing that the following criteria are met:

- \* the interest of its parent did not influence the decision to contract for Alliance and Vector transportation, i.e. there is no conflict of interest;
- \* the decision to contract for Alliance and Vector capacity was in the best interest of Union's ratepayers;
- \* no alternative option was better; and,
- \* all options were thoroughly considered.

**50** 2.10 In relation to a conflict of interest, CAC submitted that the prime interest of Union's parent, Westcoast Energy Inc. ("WEI"), was to ensure regulatory approval of the Alliance project, which was assisted by Union's long term contract. Its second interest was in securing a fair return for the Alliance pipeline through a long term contract at a high price, resulting in a conflict of interest.

**51** 2.11 According to CAC, Union acknowledged that WEI's investment in Vector was a factor in its decision to contract on the Vector pipeline. CAC submitted that WEI's interest should not have been a factor in that decision.

**52** 2.12 CAC submitted that the Board should deny Union recovery of the amount recorded in the deferral account; that the Board should find that the decision to contract on the Alliance and Vector pipelines was not prudent, and that the Board should decide on an annual basis whether Union should be allowed to recover the excess amounts paid to Alliance and Vector compared to the

TCPL rates. Alternatively the Board may reserve on the issue of prudence and require Union to provide further and better evidence that contracting for capacity on Alliance and Vector was prudent.

**53** 2.13 LPMA stated that it generally supported the position of the CAC. It contended that Union's decision to contract with Alliance and Vector should be based on an analysis of the alternatives over the life of the contract and that long term transportation contracts should be analysed in a manner similar to the investment decision related to other long term assets.

**54** 2.14 LPMA also submitted that the development of the Dawn market, in part attributable to the Alliance and Vector transportation contracts, has benefited direct purchase customers, ex-franchise customers and Union itself, in addition to system gas supply customers. Therefore, LPMA argued, the \$17.18 million incremental cost should be allocated to all of the identified benefiting groups.

**55** 2.15 LPMA also argued that Union should consult stakeholders before committing to further upstream transportation contracts.

**56** 2.16 VECC claimed that it was imprudent for Union to enter into long-term transportation contracts on the Alliance and Vector pipelines and that it is open to the Board to allow Union to bring another application for cost recovery in the 2003 CRP to address the outstanding issues related to prudence. Alternatively, VECC argued that the cost consequences of the contracts should not be borne by only system gas supply customers, but should be recovered on a volumetric basis from all other customers.

**57** 2.17 Schools submitted that decisions to acquire medium to long-term transportation contracts are among the most expensive decisions LDCs undertake. Union should consult with its stakeholders before entering into long-term transportation contracts. While Union should not require Board approval for each pipeline contract, it should provide parties with an opportunity to comment on the "... annual transport plan and its proposed plan for all proposed transportation contracts in excess of 1 year duration ...".

**58** 2.18 Schools argued that Union should provide customers with an opportunity to influence the upstream transportation plans and, in the event of disagreement, Union should be required to obtain Board approval.

**59** 2.19 CME submitted Union should be required to seek Board approval for transportation contracts longer than the period covered by the PBR plan. It claimed that it was not prudent for Union to enter into 15 year contracts, particularly when the contract "...is with a party owned in part by Union".

**60** 2.20 EGDI argued that the evidentiary record, as summarized in Union's argument, makes it clear that Union acted prudently in committing to transportation contracts with both Alliance and



Vector.

**61** 2.21 EGDI submitted that Union is not an affiliate of either Alliance or Vector and that a presumption of prudence operates in Union's favour. An allegation of imprudence is not sufficient to rebut such an assumption EGDI stated, and no evidence was filed to rebut a presumption of prudence.

**62** 2.22 EGDI did not support Board involvement in reviewing Union's upstream transportation requirements.

### *Union's Reply*

**63** 2.23 In responding to the conflict of interest issue, Union argued that there was no evidence to support the conflict of interest, "... but there is affirmative, uncontradicted evidence, utterly ignored by CAC and others in their arguments, which clearly establishes that there was no conflict with or interference by WEI in Union's decision to contract for Alliance and Vector capacity".

**64** 2.24 In reviewing the regulatory framework associated with Union's system supply functions, Union argued that it is obliged to manage a portfolio of transportation contracts to serve its system customers. Also, Union stated that it facilitates direct purchase arrangements by assigning upstream transportation capacity to customers and that Union is required to negotiate and hold the upstream transportation contracts that are assigned to direct purchasers.

**65** 2.25 Union also argued that although it receives no margin on either its commodity sales or upstream transportation contracts, the costs of these services are subject to regulatory review.

**66** 2.26 Union submitted that the basis for regulatory approval of the expansion of upstream transportation capacity has required demonstration of the market demand in the form of long-term transportation contracts, generally with a term of 10 to 15 years.

**67** 2.27 In comparison to the TCPL benchmark transportation cost, Union submitted that there were times when transportation values on the Alliance and Vector system were greater than the TCPL benchmark (i.e. Alliance Vector costs were less). Union categorized the position of CAC and VECC as arguing for an asymmetric regulatory treatment since they favoured Union absorbing the additional transportation costs above the TCPL benchmark, but not benefiting when Alliance Vector costs were less.

**68** 2.28 Union dismissed CAC's criticism of the four NRRI prudence criteria. Union claimed that it is entitled to the presumption of prudence. Parties had the opportunity of filing evidence in the present proceeding to rebut this presumption, but chose not to do so.

**69** 2.29 While Union did not accept the CAC criteria for prudence as appropriate, it claimed that the criteria had been satisfied.

**70** 2.30 In responding to the intervenor arguments that a conflict of interest existed between Union and Alliance, Union claimed that there is no evidence that WEI's 11.0 percent ownership was a material factor in Union's decision to contract for transportation. Union submitted it is only one of thirty-nine shippers on Alliance and that its capacity of 80 MMcf/d is only 6.0 percent of the total daily capacity. Union argued that an interest of only 11.0 percent was insufficient to establish an impugnable conflict of interest.

**71** 2.31 Union argued that there was no reasonable alternative to the Alliance contract in 1997, since incremental TCPL capacity was not available and other pipeline projects did not proceed. Speculation on both the availability of future supply and its price was not a reasonable option, Union argued, and there is no evidence supporting the contention that a better alternative was available to Union in 1997.

**72** 2.32 In responding to the question of "foreseeability", Union stated that no evidence was presented as to landed gas prices 4 to 5 years into the future from 1997; the prevailing market conditions in 1997 consisted of constrained transportation capacity; strong economic growth was driving the demand for natural gas; and US markets east of Chicago forecast strong demand due to development of gas fired generation stations. Union stated that several alternative pipeline projects were under consideration. However, it stated that its customers were looking to Union to secure access to firm upstream transportation to meet their growth requirements, and that it responded by following its practice of matching firm demand with firm capacity at the best price available at the time.

### ***Board Findings***

**73** 2.33 Some intervenors have argued that the Board should disallow the disposition through rates of the excess cost of transportation on the Alliance Vector system over the cost of transportation on the TCPL system for gas arriving by that route. They argued that the Alliance and Vector transportation contracts were imprudently entered into by Union. It has also been suggested that Union entered into the Alliance and Vector contracts as a result of the ownership position held by its parent company in the respective Alliance Vector systems. At the time the arrangement was entered into in 1997, WEI, Union's then parent company, owned 11% of the Alliance system. Ultimately WEI would hold 23% of the Alliance operation and a 30% of the Vector system. The other major regulated gas utility in Ontario, EGDI, also holds ownership positions in the respective Alliance Vector supply systems.

**74** 2.34 The Board acknowledges that, implicit in the framework underlying rate regulation, there is a presumption of prudence with regard to the actions of a regulated utility. It would be impractical for any regulator to examine the prudence of all individual business or operating decisions made by a utility. However, when serious questions are raised by stakeholders respecting the prudence of a utility's actions which give rise, as in this case, to material cost consequences to ratepayers, it is necessary for the regulator to examine the prudence of the utility's actions. In the

current case, the Board had already signalled its intent to review the prudence of the Alliance and Vector contracts when it directed Union to keep appropriate records and deferred the issue for consideration in this proceeding.

**75** 2.35 In every circumstance where the Board is required to consider the prudence of any action by a regulated utility, it is engaged in a review of the reasonableness of the utility's action at a given point of time in the past. The retrospective nature of such a review is inescapable. Utilities that are obliged to take action to address operational requirements must be able to do so with some confidence that their actions will be judged on the basis of circumstances obtaining at the time they are compelled to make the decision, not on the basis of circumstances which emerged afterward. This principle is consistent with the NRRI guidelines.

**76** 2.36 The foreseeability of changing circumstances is relevant to the Board's determination of prudence where the commitment or expenditure is very substantial or for a long term. A prudent decision by a utility to enter into contractual obligations for an extended period is made on the basis of reasonable assumptions covering the period subject to the contract. A poor outcome does not govern the assessment of prudence. Prudence is, however, called into question if the commitment was made casually, that is without a reasonable level and scope of analysis, or recklessly, or primarily for some non-utility or ulterior corporate purpose.

**77** 2.37 It follows then that the Board must make its assessment of the prudence of the Alliance and Vector arrangements on the basis of the conditions prevailing in and around 1997, including what then might have been a reasonable view of the future.

**78** 2.38 The record in this case benefited from correspondence between the Applicant and its then primary supplier, TCPL, respecting the availability of upstream transportation capacity to Dawn over the TCPL system from 1998 onward. The evidence suggests that in 1997 TCPL was unable to provide Union with a guarantee that additional firm service transportation would be available prior to 1999.

**79** 2.39 TCPL's situation in 1997 resulted in a projected shortfall of approximately 142 MMcf/day for November 1999 in Union's gas supply portfolio. In fact, the shortfall materialized as 108 MMcf/day, and Union supplemented its supply in the secondary market prior to the commissioning of the Alliance Vector system.

**80** 2.40 In the face of this shortfall, the Applicant determined that it should procure long term firm upstream transportation capacity from Alberta to augment its portfolio. The prudence of this fundamental determination is the first element in assessing the overall prudence of the Alliance and Vector transportation arrangement.

**81** 2.41 The lack of additional firm TCPL upstream transportation could have caused Union to procure the balance of its requirements, projected to be approximately 142 MMcf/day, through spot market or bridging activity. Union covered 40 MMcf/day in the secondary market in November

1998. The shortfall forecast for November 1999 was 108 MMcf/day, of which 39.7 MMcf/day was covered in the secondary market. Union argued that reliance on the volatile spot market for such requirements would be imprudent and unreasonably expose its customers to supply uncertainties.

**82** 2.42 The Board does not disagree that it was appropriate in 1997 for Union to seek to source at least some portion of the shortfall in its supply portfolio with an element of firm, longer term supply. That, however, does not resolve the question of the prudence of the particular arrangements chosen by Union, that is the fifteen year Alliance and Vector contracts.

**83** 2.43 Of particular note, however, is the fact that the Alliance and Vector contracts in 1997 represented a commitment for fifteen years for a quantity of upstream gas transportation representing a significant portion of Union's overall system gas supply requirement. It is also noteworthy that the Alliance and Vector contracts appear to have significantly impacted Union's engagement in the spot or secondary markets.

**84** 2.44 Union's witness, Mr. Baker, acknowledged that, other than Union and EGDI, the initial primary Alliance shippers were either producers or marketers who were affiliates of the owners.

**85** 2.45 In argument it has been suggested that the ownership position taken by Union's parent in the Alliance and Vector systems created a conflict of interest so as to render, by this fact alone, the Alliance and Vector contracts impugnable. If a conflict does exist, and the Board acknowledges that conflict of interest can arise even when "affiliates" are not involved, then in the Board's view a higher standard of scrutiny is required.

**86** 2.46 Cases will certainly arise where utilities enter into arrangements or accept commitments that are directed to non-utility corporate purposes. In such cases, ratepayers must be protected from inappropriate consequences of such actions. The Board is not persuaded that in this case there are inappropriate consequences from which ratepayers require protection.

**87** 2.47 The Board notes that WEI had no investment in Vector at the time Union entered into the arrangement with that pipeline, and 11% in Alliance when it entered into the contract with Alliance. The Board is not persuaded that the position procured by WEI in the Alliance and Vector systems was the reason behind the decision by Union to enter into the Alliance and Vector contracts.

**88** 2.48 The Board also finds it noteworthy that the Union system gas volumes represent a relatively small proportion of the overall Alliance and Vector capacity.

**89** 2.49 The Board must consider the alternatives available to Union in 1997 to accomplish an appropriate balancing of its supply arrangements. Whatever other options may have been present, sourcing sufficient incremental firm requirements through TCPL does not appear to have been one of them. The evidence supports the assertion that in 1997 TCPL had indicated that incremental supply for 1998 and 1999 would not be available, absent the expansion of TCPL capacity through the completion of the NEXUS project. The evidence indicates that, at the time the Alliance Vector

contracts were entered into by Union, the NEXUS project had been cancelled. There is no evidence before us to support a contention that TCPL was able, through any means, to offer upstream transportation capacity adequate to meet Union's requirements. Reliance by Union on the TCPL system for its additional firm capacity requirements would, under the circumstances, appear to have been unrealistic.

**90** 2.50 The only other alternative for firm upstream transportation rested with the Panhandle and Trunkline systems. In fact, the Applicant has utilized these systems for portions of its overall supply chain. The gas supplied through these systems arrives at a price that to date exceeds the landed cost of gas arriving on the Alliance and Vector pipelines.

**91** 2.51 It is noteworthy that the disparity between the Alliance and Vector delivered price and the TCPL reference price would be reversed by a change in the rate of exchange between the Canadian and the US dollar. If the Canadian dollar was trading at higher levels, there would not be any disparity between the Alliance Vector price and the TCPL price, and the issue of prudence of the Alliance Vector commitment might not have arisen.

**92** 2.52 The term of the arrangements has caused the Board considerable concern. While securing firm supply appears to have been a reasonable response to the conditions facing the Utility at the time of contract, the length of its commitment requires separate analysis.

**93** 2.53 Union' evidence disclosed that its commitment was not a requirement in the regulatory approval of either of the Alliance or Vector pipelines.

**94** 2.54 Union's acceptance of the fifteen year term appears to have been based on two elements. First, the pipelines bargained aggressively, and only wanted to contract for relatively long terms. Second, the Utility has developed an approach to gas supply strategy which involves the procurement of long term firm supply to support long term firm demand.

**95** 2.55 It has been a long standing industry practice to require lengthy contractual terms. In part this has derived from the regulatory process which often obliges parties seeking permission to construct pipelines to demonstrate long term commitments from users. While that was not a factor in this case, supply contracts for terms of ten to fifteen years are not outside of the normal range for such arrangements.

**96** 2.56 The Board accepts that the Utility's supply strategy is a defensible approach to ensuring that its system customers will have predictable and secure access to the requisite supply of the commodity. The Utility should ensure however that such a policy is adapted to changing circumstances in the marketplace and the regulatory environment. In the instant case, providing long term firm supply through the Alliance Vector arrangements was, we find, a reasonable measure. Future panels may find that the application of such a policy at a given point in time, under different circumstances, and with a different record, to be inappropriate.

**97** 2.57 The Board finds that the Applicant has provided sufficient evidence to support a finding that it was prudent under the circumstances then prevailing to enter into the Alliance Vector arrangements. Although the Board acknowledges some concerns, on balance, the Applicant's evidence and argument are persuasive. The Board will therefore allow Union to recover the accumulated debit balance of \$17.18 million.

**98** 2.58 The Alliance Vector calculated variances tracked within the Other Purchased Gas Cost deferral account (179-68) to December 31, 2001, should be disposed of together with other amounts posted to that account, and furthermore, there is no longer a requirement for tracking the prescribed variance.

## **2.2 FAILURE TO BALANCE PENALTIES**

**99** 2.59 Union has proposed a change in the treatment of direct purchase customers which fail to balance annually to their contractual obligation to deliver gas to Union, within the contractually specified 4% tolerance.

**100** 2.60 Currently, these customers, if short on their deliveries to Union at the annual date for balancing are charged the then-approved weighted average cost of gas ("WACOG") for the volumes required to balance and, upon disposition of the deferral account balances for the year, an additional amount based upon the difference between the WACOG and the average cost of Union's spot gas purchases for the quarter in which the failure to balance occurred. If Union had not purchased any spot gas in that quarter, only the WACOG charge would apply.

**101** 2.61 Union has proposed in this Application that the penalty for direct purchase customers who fail to balance within the 4% tolerance be based on the highest daily spot price (as reported in the Canadian Gas Price Reporter) during either the month of or the month following the failure to balance, whichever is higher. The Other Purchased Gas Deferral Account would then be reduced by the difference between this charge and the approved WACOG, so that penalties go to the benefit of ratepayers and do not go to the benefit of utility earnings.

**102** 2.62 Union noted that any additional amounts levied in respect of customers who had not balanced would be posted to the Other Purchased Gas Deferral Account, "... [s]o these charges benefit the customers who are not guilty of contract breaches."

**103** 2.63 Union stated that the rationale for the proposed change was that under the current system there was insufficient incentive for direct purchase customers to balance. Because Union's imbalance penalties do not reflect market prices for gas at the time of default, a number of these customers have made a choice to rely on Union's system sales portfolio to balance. Union submitted that this phenomenon has had adverse cost impacts on other franchise customers.

**104** 2.64 Union argued that its proposal, by levying the penalty at the time of imbalance -- thus strengthening the link "between the violation and the cost consequences" -- and by reflecting market

prices at the time of the choice to not balance, would provide sufficient incentives to ensure that the cost consequences arising from direct purchasers strategically choosing not to balance would not be visited on system gas customers.

### *Intervenors' Positions*

**105** 2.65 A number of intervenors supported the Applicant's proposal, on the grounds that the preservation of the integrity of the system as a whole requires a more demanding penalty for non-compliance with contractual balancing obligations. Most of these intervenors also expressed reservations respecting the application of the revised penalty provisions to direct purchasers whose failure to balance arose prior to the date of this Decision.

**106** 2.66 Two intervenors, Schools and IGUA, and two observers, Barnett and Oxford, rejected Union's proposal in its entirety. In separate submissions Schools and IGUA asserted that the existing penalty structure, the availability of purely contractual remedies, and the provisions appearing in current rate schedules provided all the incentive that is needed to encourage direct purchasers to balance according to their respective contractual obligations. They also sharply rejected the application of any revised penalty methodology to instances of default arising prior to the issuance of this Decision. They characterized this aspect of the Applicant's proposal as retroactive rate making.

**107** 2.67 IGUA submitted that the charges "... should be commensurate with the charges reflected in rate schedules currently approved by the Board for drafting the system", noting that the T1 and T3 rate schedules include a "Reasonable Efforts Backstop Gas" rate applicable to drafted volumes; further, the rate specified "... appears to be linked to WACOG in some fashion." IGUA also noted that in the Northern and Eastern Operations Area, the Rate 30 schedule includes an intermittent gas supply charge of \$5/10<sup>3</sup>m<sup>3</sup> plus the greater of the cost of incremental gas or the customer's gas supply charge. IGUA submitted that penalty charges, for bundled, direct purchase drafters should be consistent with the approved charges on the T1, T3, and rate 30 schedules.

**108** 2.68 Barnett and Oxford described the effect of the application of the proposed revised penalty structure to their existing defaults as "devastating". Barnett in particular cited a fundamental failure of communication and cooperation between itself and Union as a major contributing factor in its default. It submitted that penalties which would be applied if the Applicant's proposal were to be approved without revision are very significant.

**109** 2.69 Kitchener did not support Union's proposal arguing that this type of change should not be made in the mid-term of the PBR plan in the absence of evidence of a material need.

### *Union's Reply*

**110** 2.70 Union disputed the characterization of its proposal as retroactive, submitting that

customers were advised on October 3, 2000, of the proposal to use the highest spot price at Dawn in the month following contract expiry, and marketers were advised of the proposal on September 27, 2000. The Board was advised of the proposal on October 24, 2000.

**111** 2.71 Union reiterated that the rationale for the proposal was to minimize or eliminate the incentive for direct purchasers to rely on system supply, thereby shielding other customers from balancing costs incurred by Union.

**112** 2.72 Union noted that in respect of imbalance charges, the bundled-T contract refers to the R1 rate schedule. This schedule states that the drafting charge (i.e., "Banked Gas Purchases") will be the WACOG plus additional charges as approved by the Board. As such, the calculation of additional charges is not specified on the rate schedule.

**113** 2.73 Union added that in response to inquiries from marketers and customers who were considering failing to balance, Union advised them as to what the "old calculation [of the imbalance penalty] was" and further, that Union was seeking additional penalties that "would not be attractive if customers did not balance."

**114** 2.74 Union argued that "[c]ustomers had ample time to balance their contracts expiring at the end of October 2000 after receiving the communication approximately a month in advance. They did not all do so, presumably, because the price was high, the costs of drafting the system were low and these customers just decided to take their chances that higher charges would not be approved. Their conduct, in other words, simply further confirms the need for higher charges."

**115** 2.75 Union cited p. 16, para. 3.2.13 of the Board's EBRO 493-04/494-06 Decision with reasons issued February 10, 1998, as an instance in which the Board approved the retroactive application to contracts that had expired in the previous year, of the average spot gas cost incurred by Union in the quarter of contract expiry: "With respect to the specific allocation of \$1.448 million of costs to direct purchase customers who were out of balance by more than the allowed contract tolerance at contract year end, the Board is satisfied that customers should have been aware as a result of the Board's Decision in EBRO 493/494, of the prospect of such charges arising, and approves the proposed disposition."

**116** 2.76 Union added that it arranges supply to balance the system. Neither specific volumes nor costs are streamed to direct purchase customers and it is impossible to calculate Union's costs of balancing those who do not balance themselves. Further, Union claimed that direct purchase customers would continue to rely on system gas for balancing when economic. Union asserted that it was inappropriate for customers who had accepted responsibility to buy their own gas "... to jump back and forth between direct purchase and system supply when it suits them, which is effectively what happens when a direct purchase customer relies on Union to balance its requirements at contract year end."

**117** 2.77 With respect to IGUA's reference to the T1 and T3 "Reasonable Efforts Backstop Gas"



rate, a rate at which customers with negative storage balances will have been deemed to have been sold gas, Union cited the associated difficulties mentioned by Mr. Packer in his testimony. The rate is pegged to WACOG and includes the first block M2 rate. As such, if gas prices spike upwards, customers may rely on this rate for balancing.

**118** 2.78 Regarding the position advanced by some parties that Rate 30 service provided an alternative balancing function, Union remarked that this was an intermittent gas supply that was only available in the Northern and Eastern Operations area and was not intended as a balancing instrument for direct purchase customers.

**119** 2.79 Union stated that "the fact that the charges under the new methodology exceed the charges under the old is irrelevant" Union argued that whereas the old methodology reflected the timing of Union's spot gas purchases, the new methodology more accurately reflects available market alternatives. Union observed that direct purchasers were facing adverse financial consequences because market prices were increasing when many contracts were expiring and customers waited to decide as to whether to balance or not.

**120** 2.80 Union repeated that there is no shareholder benefit under the proposal. All charges derived from the penalty are credited to the Other Purchased Gas Costs Deferral Account.

**121** 2.81 Union concluded that absent the proposed change, direct purchase customers will choose to balance using system gas whenever it is economic to do so, and that, in choosing to not honour their contractual obligations with gas that they have purchased independently, they will impose costs on other customers.

### ***Board Findings***

**122** 2.82 The Applicant has proposed to significantly alter the method for the calculation of the Failure to Balance penalty. This penalty is imposed on direct purchase customers which fail to balance deliveries of gas according to their contractual obligation to Union.

**123** 2.83 The prevailing "penalty" is imposed on defaulting direct purchasers which fail to balance within 4% of the contractual undertaking. The first component of the current formula for the calculation of the penalty in the event of a shortfall in the customer's deliveries consists of a charge equivalent to the contemporaneous Alberta WACOG applied to the shortfall in volume required to balance to within 4% of the contract obligation.

**124** 2.84 In addition to this amount, the defaulting direct purchaser is charged an amount representing the extent to which the spot market price paid by Union exceeded the WACOG at the time of failure to balance. This calculation is performed at the time of the disposition of the respective accounts for the year, and is only charged if Union did, in fact, purchase additional volumes on the spot market, at the spot market price, during the period of default.

**125** 2.85 The penalty as currently designed is intended to achieve two purposes: first, it ensures that Union is made whole in light of a direct purchaser's default; and second, it provides a disincentive to a direct purchaser to default on its obligation.

**126** 2.86 The Applicant's proposal in this proceeding points to deficiencies in the structure and effect of the current penalty. First among these is the possibility that a strategic direct purchaser may choose to fail to balance, because the current penalty formula, under some market conditions, creates an incentive to default. The penalty imposed may expose a direct purchase to a lower cost than it would face if it purchased its own gas to cover this shortfall.

**127** 2.87 In addition, Union stated that the current penalty methodology does not adequately recognize the burden of extra cost and effort expended by the Utility in managing balance shortfalls. The failure to balance requires further adjustments within the system as a whole and operates to the detriment of all compliant customers.

**128** 2.88 The Applicant has asked the Board to permit it to apply the proposed change in penalty methodology going forward, and against all defaulting direct purchasers from October 31, 2000, to date.

**129** 2.89 The proposed change would become more punitive in that the charge would be calculated on the basis of the difference between the WACOG price and the highest spot market price prevailing in the month of contract expiry, or the month following contract expiry, whichever is higher.

**130** 2.90 There appears to be no strategic advantage to be gained by a defaulting direct purchaser. The amounts imposed as penalties would, as now, be applied to gas supply deferral accounts so as to benefit compliant customers.

**131** 2.91 The Board accepts the premise that it is important to encourage compliance with contractual obligations to balance in a system such as Union's, where a wide variety of users are dependent on such balancing to ensure the integrity, security and efficient operation of the system. The failure to balance can place compliant system participants at risk, and may result in additional costs.

**132** 2.92 The Board approaches proposed changes to elements of the PBR plan cautiously. As stated elsewhere, extracting discrete portions of the PBR plan for revision can be unwise, given the presumed interdependence of the components of the PBR plan as a whole.

**133** 2.93 However, the proposed changes, in the Board's view, are an improvement and enhance equity among customers. Gains in system efficiency resulting from greater compliance with contractual obligations is consistent with expectations which underlie the Board-approved PBR plan.

**134** 2.94 Some intervenors expressed concerns that such penalties ought to be limited to cost recovery related to the default.

**135** 2.95 In the Board's view, the penalty must be sufficiently costly to defaulters to strongly discourage strategic non-compliance with balance obligations, and the careless or incompetent acceptance of contractual obligations which are not reasonably achievable. The Board is concerned that parties wishing to engage in the market, either directly or through agents, must be appropriately encouraged to manage their obligations responsibly. The system as a whole requires that.

**136** 2.96 The Board does not accept the Applicant's proposal that the revised penalty be applied against defaulting direct purchasers in respect of defaults that occurred prior to the date of this decision. As indicated above, the primary purpose of the penalty is to influence the behaviour of market participants, and past behaviour cannot be influenced. Defaulting direct purchasers, whose defaults have occurred prior to the date of this decision, shall be subject only to the penalties calculated and imposed under the current structure. The Board acknowledges that Union made an effort to advise direct purchasers that it had applied to the Board for a sharply increased penalty provision governing a failure to balance. This effort however is not an adequate justification for the imposition of the new penalty methodology not yet imposed by the Board on those whose defaults have already occurred, and for whom application of the new methodology may be very significant. In the Board's view, this would be an inappropriate exercise of retroactivity.

**137** 2.97 Accordingly, the Board accepts the Utility's proposal with respect to a new, more demanding penalty to be applied to direct purchasers who have failed to meet their contractual obligations to balance supply. The revised penalty shall apply to all incidents of default arising after the date of this Decision, and after potentially affected customers have been clearly notified by Union of this Decision and shown, by example, how a penalty would be applied. It will not be applied with respect to incidents of default which have arisen prior to such notice.

## **2.3 DEMAND SIDE MANAGEMENT AND LOST REVENUE ADJUSTMENT MECHANISM**

### ***Background***

**138** 2.98 Union introduced demand side management ("DSM") programs in the 1990s and savings targets were established against which to measure the performance of Union's programs. The targets for reduced consumption were reflected in volume forecasts for ratemaking purposes. The Board accepted as part of a settlement agreement in EBRO 499 a Lost Revenue Adjustment Mechanism ("LRAM") to account for margins if the results achieved by Union's DSM programs differ from the reduced consumption levels reflected in rates. The amounts related to such DSM program savings are accumulated in the LRAM Deferral Account (179-75) for future disposition.

**139** 2.99 In RP-1999-0017, Union proposed the introduction of a DSM framework for implementation within its proposed PBR plan. The Board expressed concern that certain policy

issues, such as the appropriate party or parties responsible for DSM and the role of DSM within a utility and within a PBR plan, required consideration. The Board also noted that no party supported Union's proposed DSM framework. While acknowledging that the facilitation of energy efficiency is one of the objectives of the Act, the Board found that there may be a need to better understand the role of the distribution utility in DSM programs and, in the absence of stakeholder support, the Board was not prepared to endorse the proposed DSM framework. The Board stated that it expected Union to continue to offer its existing DSM programs, including continuing the LRAM, and that new DSM programs could be provided if they were cost-effective under the Board-approved PBR plan.

**140** 2.100 In this proceeding Union filed evidence on its DSM activities for 1999, 2000 and 2001 and sought clearance of its LRAM deferral account balances for 1999 and 2000. Union also proposed to clear its estimate of LRAM balance for 2001 at the time of the disposition of the December 31, 2001, balances in its other deferral accounts. Union further proposed that, going forward, rates should be adjusted prospectively to reflect an amount equivalent to the LRAM amount approved for disposition in the previous year in order to avoid the accumulation of large balances for disposition by way of one-time charges to ratepayers.

**141** 2.101 In the ADR settlement agreement parties agreed that any amounts accumulated for the year 2001 should be cleared from the deferral account in the current proceeding and included in rates for 2002. Since the balances for 2001 may not have been subject to audit, parties agreed that any differences between the unaudited and the audited balances should be trued-up in the 2003 CRP. There was no agreement on any other DSM related issue.

**142** 2.102 As a result of further discussions, primarily between Union and GEC, most issues arising from the audit of its DSM program results were settled.

**143** 2.103 The following unsettled DSM issues were addressed in this proceeding:

- \* the appropriate treatment of free drivers, those customers who have been influenced by Union's actions but do not report their purchases to Union in the High Efficiency Furnaces Program;
- \* the accounting treatment of volumes attributable to DSM in the first year of a program; whether it is appropriate to include the full annualized savings or only 50% of the annualized savings of a program in the first year it is offered. If only 50% of 1999 DSM program savings is recognized in the first year, whether an adjustment should be made for 1998 DSM program savings;
- \* the clearance of the LRAM balances. The issues are whether there are

DSM savings for 1999, 2000 and 2001 embedded in rates, and if so should the recovery reflect all savings or just the variance from the embedded DSM savings; and,

\* disclosure of material and information.

*Union's Argument in Chief*

**144** 2.104 Union stated that there were two outstanding issues related to the DSM program. The first involves the free-driver rate for the High Efficiency Furnaces Program and the quantification of DSM costs in the start-up year: the amounts at issue are \$1.261M and \$2.543M respectively. The second issue involves the extent to which DSM savings targets for 1999, 2000, and 2001 are already embedded in volumes used for ratemaking and, hence, bears directly on the computation of the LRAM balance.

**145** 2.105 Union defines a "participant" in a DSM program as a customer which purchased high efficiency equipment as a result of some action -- an incentive payment or information -- undertaken by Union and reported by the participant in a DSM program.

**146** 2.106 "Free riders" are participants who take advantage of the utility's offers (e.g., receive a rebate) but would have purchased the high efficiency equipment without the incentive; in the residential high efficiency furnace market, Union uses a 60% free rider rate, the effect of which is to reduce the unit impacts in the net savings by 60%.

**147** 2.107 "Free drivers" are those customers which have been influenced by Union's actions yet do not report their purchases to Union. The effect is sometimes referred to as the "spillover" (onto non-participants) effect.

**148** 2.108 In 1999, Union commissioned a study of residential customers' purchasing decisions, surveying participants and non-participants in the Home Equipment Replacement program. This study supported the existence of a spillover effect and quantified the proportion of free drivers at 15% of the new (i.e., not previously counted) program participants.

**149** 2.109 Union stated that it

"... spends about half a million dollars a year on educating customers and promoting high-efficiency furnaces. It does so through material distributed directly to customers and through working with the heating ventilation and air conditioning community. The material distributed by Union includes bill inserts, cost comparison sheets and wise energy use guides. Some of these educational programs have been in place for up to seven years and these educational initiatives are designed to try to transform the market; that is, to fundamentally

affect customers' perceptions of high-efficiency equipment and to, in effect, make it the norm rather than the exception. The purpose of this customer education activity is to generate spillover or free drivers. In other words, to get people to buy high-efficiency furnaces even if they do not participate in an incentive program."

**150** 2.110 With respect to the second issue, Union argued that for new DSM measures instituted in the years 1999, 2000, and 2001, it had "included 100 percent of the savings for those new measures in each year. This simplifying assumption included the assumption that there was no DSM activity from prior years for which no rate recovery had been obtained, having any effect in 1999, 2000, and 2001."

**151** 2.111 Union argued that if its assumption, that 100% of savings are realized in the first year, is revisited, then its other assumption, that there is no DSM savings from a prior year, must also be revisited. Union asserted that implicit in the position taken by GEC's witness was that DSM impacts are felt in years after they are introduced: if the starting assumption is re-evaluated, then the effects of its 1998 DSM activities on 1999, 2000, and 2001, savings should be reevaluated.

**152** 2.112 Union submitted that although it had not applied to recover lost margins for subsequent years due to 1998 DSM activities (due to its 100% first-year impact "simplifying assumption"), it could make such a claim under the terms of the EBRO 499 ADR agreement and the associated accounting order because neither limits the margin impact related to measures implemented in 1999 or thereafter. The account is to capture the margin impacts of DSM savings realized in 1999 and thereafter. Therefore, the fact that Union did not have an LRAM account in 1998 is irrelevant.

**153** 2.113 Union submitted that "... the record [was] replete with references to the fact that there were never any planned 1999, 2000, or 2001 DSM savings actually incorporated into Union's forecast for its 1999 rates" and that no specific DSM adjustments had been made since.

**154** 2.114 With respect to Union's EBRO 499 DSM evidence, Union argued that although consideration was given to adjusting the 1999 volume throughput forecasts for DSM activities when the EBRO 499 evidence was being prepared, the 1999 volumes were ultimately determined by using a trend line of the normalized annual consumption ("NAC") based on 1993-7 data as agreed to in the ADR settlement and no adjustment for DSM was made.

**155** 2.115 Union noted that the 1999 LRAM balance of \$1.6M presented in the RP-1999-0017 proceeding, represented 100 percent of the 1999 target savings.

**156** 2.116 Union's witness testified that whether lost revenue is captured in rates or recovered later through a deferral account is a matter of indifference to rate payers. Furthermore, the LRAM should ensure revenue neutrality with respect to volume variances arising from DSM activities.

### *Intervenors' Positions*

**157** 2.117 GEC noted that all parties agreed that the purpose of the LRAM is to make the utility indifferent with respect to the revenue impacts of over or under-performance on DSM relative to forecast DSM volumes. GEC submitted that, contrary to Union's evidence in this proceeding, the record in the EBRO 499 proceeding clearly indicated that the gas volume forecast was to be taken to include targeted savings and also that the approved LRAM was to be a symmetrical variance account.

**158** 2.118 GEC submitted that it was irrelevant whether Union erred, bargained badly, or was revising history: what mattered was that the Board uphold the ADR agreement: since the EBRO 499 ADR incorporated DSM savings, it is not punitive.

**159** 2.119 GEC argued that the forecast DSM volumes deemed to be in the gas volume forecast and against which LRAM variances are calculated for 1999 should be 50% of the annualized volumes set out in Union's pre ADR DSM filings in EBRO 499. The full annualized numbers should be used for the LRAM treatment of 1999 program in subsequent years.

**160** 2.120 GEC disputed Union's claim to any savings related to 1998 DSM programs arguing that there was no LRAM approved prior to EBRO 499 and there was also no accounting order to enable recording of such balances.

**161** 2.121 GEC argued that awarding an LRAM for pre-1999 DSM programs could not remove DSM disincentives (as is the purpose of an LRAM.)

**162** 2.122 For 2000 and 2001 GEC argued that the LRAM be calculated on an all savings basis until gas volume forecast assumptions are changed. The impacts in the year of implementation of a program should be on a 50% basis with the full annualized impact being used in subsequent years.

**163** 2.123 GEC argued that High Efficiency Furnaces Program participation should not include any recognition for free drivers on the grounds that Union's submissions were not well documented or evaluated and this proposal was unique.

**164** 2.124 GEC noted that Union's proposal to recover approximately \$1.2M for free-drivers in 1999 and 2000 is double the claim for actual participants in the high-efficiency furnace program.

**165** 2.125 GEC noted that the 15% free driver rate in the Quantec study assumes a 79% free rider rate. GEC characterized Union's use of the Quantec study as "cherry picking" since it was applying the 15% free-driver rate but not the 79% free-rider rate.

**166** 2.126 Although accepting that there may be some free drivers, GEC argued that Union's claim in this application had not been "extremely well evaluated and documented". GEC continued that "[i]t would be a poor precedent and set a weak standard to allow the first ever free driver claim

in Ontario on the basis of poor analysis." GEC urged the Board not to allow Union's free driver claim.

**167** 2.127 GEC stated that the Board-endorsed DSM consultative process had fallen into disuse and contrasted Union's approach to DSM with that of EGDI noting that in the case of Enbridge, DSM issues have not required any hearing time since 1998. GEC submitted that "[a] clear direction to the Company on disclosure will greatly assist in the proper functioning of the consultative process."

**168** 2.128 GEC noted that 20 of GEC's 22 initial DSM volume issues were quickly settled after Union provided information requested by GEC, including redacted studies previously withheld on the basis of confidentiality considerations.

**169** 2.129 GEC disputed Union's concerns regarding the commercially sensitive nature of the Quantec study information, arguing that under a confidentiality agreement even identifying information can be disclosed; otherwise, it is too easy for the utility to withhold information necessary to test proposals.

**170** 2.130 GEC asked the Board to direct Union to disclose, on an ongoing basis and without redaction all evaluation studies to the DSM consultative members.

**171** 2.131 Pollution Probe dealt with one issue in its argument: the timing of the recognition of impacts. Pollution Probe stated that the EBRO 499 evidence contemplated that the LRAM was designed to capture the variances between forecast and actual DSM savings and hence that DSM savings were incorporated in the gas volume forecasts. Pollution Probe argued that Union was seeking to retroactively change the Board's EBRO 499 Decision without adequate evidence and that the Board approved symmetric LRAM keeps Union revenue neutral with respect to actual DSM savings. Pollution Probe submitted that the Board should approve LRAM balances of (\$83,941) for 1999 and (\$715,843) for 2000, plus interest, rather than the amounts requested by Union.

**172** 2.132 CME concurred with others that Union's EBRO 499 evidence does not support Union's claim that DSM volumes were not factored into its 1999 load forecast. CME supported GEC's position that it is appropriate to use 50% of the annual savings to determine the first year impact of a program.

**173** 2.133 CME argued that Union, through this Application, is seeking approval of an asymmetric LRAM determination methodology. CME agreed with Pollution Probe's witness that Union has not relied on the Board-approved LRAM balance methodology.

**174** 2.134 CME argued that regardless of whether Union's position is correct or not, Union should not be allowed to have what amounts to retroactive adjustment to the deferral account and that rate payers should not have to shoulder these costs.



**175** 2.135 CME argued that Union's DSM auditor's relationship with Union was structured so as to compromise the appearance of the auditor's independence. CME was also concerned that Union controlled the information gathered with respect to DSM and appeared to control its provision to intervenors in this proceeding. CME also expressed concern over the disclosure of DSM information by Union. CME supported the DSM consultative process and suggested that Union model its process on EGDI's.

**176** 2.136 LPMA argued that DSM programs would have a half year's impact in the first year they were offered. LPMA accepted the free driver estimate of the Quantec report but argued that Union should not selectively choose data from it.

**177** 2.137 VECC concurred that DSM impacts were embedded in Union's 1999 gas volume forecast but conceded that the impacts of the 2000 and 2001 DSM programs are not.

**178** 2.138 VECC argued that since not all programs are implemented on January 1, it is not appropriate to calculate the LRAM balance as if they had. VECC considered it logical to establish an LRAM adjustment with a mid-year saving as this parallels the rate payer protections associated with the customer additions mechanism.

**179** 2.139 VECC argued that the Board should approve the use of the complete results of the Quantec study.

**180** 2.140 CAC described the record on whether DSM savings were incorporated in 1999, 2000 or 2001 gas volume forecasts as "unclear" but accepted Union's position that they were not.

**181** 2.141 Furthermore, CAC submitted that in the first year of offering of a DSM program only 50% of its annualized savings should be included in the LRAM.

**182** 2.142 CAC argued that Union's proposed treatment of free drivers amounted to Union seeking credit for customers' decisions to comply with the objectives of the program but not formally participate in it and that Union had not provided a sufficient evidentiary basis for incorporating free drivers into its DSM savings methodology.

**183** 2.143 CAC recommended that the Board initiate a process to receive parties' proposals on:

- \* the future direction of the DSM process
- \* the scope of the DSM consultative
- \* the evaluation of DSM programs

\* information requests and time lines.

**184** 2.144 CAC recommended that DSM issues for EGDI and Union be considered in the same forum.

**185** 2.145 IGUA argued that the Board must determine the amount of DSM savings implicit in the 1999 gas volume forecast. IGUA argued that the LRAM was not approved by the Board to protect the utility from the lost margin consequences of energy efficiency, however they are caused.

**186** 2.146 Schools argued that Union's 1999, 2000 and 2001 LRAM balances reflect the gross DSM savings, not the variance from target saving. Schools asserted that the LRAM should not be manipulated into something it was not intended to be.

**187** 2.147 Schools argued against including the proposed number of free drivers in the determination of DSM savings.

### *Union's Reply*

**188** 2.148 Union argued that GEC and CAC did not acknowledge that the Furnace High Efficiency Information program proposed by Union and approved by the Board in EBRO 499 included the impact of free drivers.

**189** 2.149 In reply to the assertion that Union claimed two free drivers for each net participant, Union argued that this was "misleading" due to the discounting of program participants by the 60% free rider rate to calculate net participants. Union stated that in 2001 it had 7,460 participants, counting 3,487 free drivers, for a participant to free -driver ratio of 2 to 1.

**190** 2.150 Union disputed CAC's, GEC's, and LPMA's contention that it had "cherry picked" the Quantec study, arguing that the study was not evidence that the free rider rate should be revised. Rather, since the free rider rates have been influenced by Union's DSM programs being available in the market for a number of years, to keep Union whole, "... the free rider rate should remain constant over the plan period."

**191** 2.151 With respect to the "half year impact" of new DSM programs, Union argued that GEC's proposal would exclude the lost 1999 margin from the impact of 1998 programs in 1999.

**192** 2.152 Union noted that the accounting order and ADR agreement in EBRO 499, allowed it to record all savings starting January 1, 1999, and it was therefore entitled to collect the annual impacts of 1998 DSM programs on 1999 lost margin. Union repeated that, although it had not claimed any 1998 program savings, if a timing adjustment is to be made for new programs then at least half of the annualized impact of 1998 programs on 1999 should be reflected in the LRAM balance.

**193** 2.153 Union repeated that the fact that there was no LRAM in 1998 was irrelevant since it

was not seeking lost margin for 1998; however, the impact of measures started in 1998 continue through 1998-2001. Union calculated that, under the half-year rule it had lost \$883,000 in 1998 from 1998 DSM activities, an amount not reflected in rates since 1998 was not a test year. Union added that the argument that extending its logic would result in recording the impact in LRAM of all previous DSM activity was fallacious since the DSM impacts up to 1997 were in rates due to the ADR agreed throughput.

**194** 2.154 Union stated that the LRAM amounts recorded gross lost revenue due to DSM for 1999, 2000, and 2001 because no DSM savings had been built into rates for those years and hence, for revenue neutrality to obtain, the pivot must be zero DSM savings.

**195** 2.155 Union remarked that CAC, GEC, IGUA, LPMA, and VECC agreed with a zero threshold for 2000 and 2001, on the basis that no DSM savings rate adjustments had been made.

**196** 2.156 Union disputed GEC's arguments relating to parties' beliefs with respect to the amount of savings in rates pursuant to the EBRO 499 ADR, arguing that what mattered was not a question of belief, but rather the actual amount of lost margin revenue in rates. In this respect, Union submitted that all parties that were arguing that some amount of the DSM target were included in rates, were incorrect. Parties adopting this position for 1999 were wrong "... because the EBRO 499 ADR Agreement replaced Union's volume forecast with one which did not include any adjustment for DSM savings from the 1999 DSM plan activities. Parties contending that the 2000 and 2001 targets are included in rates are doubly wrong because the Board's decision on 2000 rates and the approved trial PBR plan did not provide for any adjustments to rates to reflect the impact of DSM activities in 2000 and 2001."

**197** 2.157 For 1999, Union "concede[d] that the pre-filed evidence in EBRO 499 may have been ambiguous on the issue" of inclusion of DSM savings. However, Union asserted that the record was "now clear" due to the testimony of Mr. Fogwill in RP-1999-0017 and Mr. Baker in this proceeding that there were no savings included.

**198** 2.158 Union stated that the amount of savings in Union's original 1999 volume forecast was irrelevant to the LRAM balance since it did not form the basis for the throughput settlement. Union asserted that the EBRO 499 ADR clearly modified its pre-filed evidence, replacing the forecast normalized average consumption ("NAC") for each general service class.

**199** 2.159 Union highlighted the text modifications from the original draft EBRO 499 accounting order filed, and from the rate order issued after the ADR. While the draft order required recording the difference between actual margin savings and the margin reduction included in rates, the ADR agreement and the approved accounting order refer to recording the margin impact of all DSM savings realized. Union argued that these clearly reflected changes from the pre-filed evidence: with no DSM adjustment in the volume forecast, the LRAM needed a zero-savings pivot to be revenue-neutral.

**200** 2.160 Union acknowledged that there was some incremental DSM implicitly included in rates 1999 but took issue with CAC's and Schools' submission that implicit DSM in rates was double Union's estimate. Union stated that the 499 ADR forecast took five years of actual NAC declines and the estimate of implicit DSM savings should reflect the savings achieved over the same five years.

**201** 2.161 Union argued against Pollution Probe, CME and Schools suggestion that DSM plan targets be used as there was no basis for this punitive proposal. Union submitted that its proposal neither disadvantaged nor advantaged any party.

**202** 2.162 On the question of disclosure of information Union stated that the DSM consultative was provided with an unredacted executive summary of the Quantec study, two years earlier. GEC was in the consultative, it had already been provided with the information sought. As the Board has a procedure to deal with confidentiality issues, Union submitted that the Board should not grant GEC's request to direct disclosure as it would prejudge future circumstances; instead, the Board should deal with disputes as they arise.

**203** 2.163 Regarding the consultative process itself, Union urged the Board to "not reach into the planning processes of the company to direct how its operations are planned" as a matter of regulatory practice and of jurisdiction.

**204** 2.164 Union responded to CME's concerns over the independence of the auditor, stating: "... an independent auditor is a third party at arms length from Union. The auditor is not an employee of Union. The fact that the terms of reference of the engagement and the payment for service come from Union does not remove independence."

**205** 2.165 Union argued that ever-increasing levels of DSM, while providing a "social good," reduced Union's revenues. Union stated that increased rates due to the DSM program costs and the associated revenue reduction could reduce the competitiveness of natural gas over time. Further, DSM participants are subsidized by non-participants.

**206** 2.166 Union submitted that a reconsideration of DSM implementation and a timely evaluation of DSM for the natural gas utilities "may well be warranted," noting that electricity distributors were not required to engage in DSM. Union also quoted from the Board's RP-1999-0017 Decision (para. 2.666): "Moreover, there is a need to evaluate whether the distributor, while being charged with the responsibility for providing non-discriminatory access to services required to facilitate a competitive gas market, should at the same time engage in managing gas demand other than for reasonable efficiencies in the operation of the distribution system."

**207** 2.167 Union stated that it had pursued DSM in good faith as parties and the Board had agreed that Union would be kept whole for these activities including in respect of LRAM balances for 1999, 2000, and 2001. Union cited the position of some intervenors -- to leave Union uncompensated for its LRAM balances -- as supporting reconsideration of the appropriateness of

conservation-based efforts by gas distributors.

### ***Board Findings***

#### *General*

**208** 2.168 The Board has made its findings under five headings: free drivers, the half year methodology, the clearance of 1999, 2000 and 2001 LRAM Deferral Account balances, information disclosure and the future role of the utility in DSM program activity.

#### *Free Drivers*

**209** 2.169 The Board finds that it does not have sufficient evidence before it to be able to conclude that the free driver rate claimed by Union is accurate. The inclusion of a factor to represent those who were not participants in the High Efficiency Furnaces Program but who were notionally influenced by the program is by its nature speculative. The Quantec study which forms the sole basis of Union's position on this issue, simply is not sufficiently detailed or documented to enable the Board to include any free driver factor at this time.

#### *The Half Year Methodology*

**210** 2.170 The Board finds that the most appropriate simplifying assumption for the calculation of the volume savings associated with any DSM program is one which is based on a 50% allocation of the effects to the year in which the program is introduced. Thereafter, 100% of the savings associated with the program may be allocated for every year in which the program operates until the rates are revised to reflect the reduced volumes resulting from the savings from the DSM program. This assumption imitates the approach taken by the applicant with regard to customer and capital additions and more closely reflects the 1999 savings achieved from the new program.

**211** 2.171 The applicant has submitted that if the allocation of DSM savings is limited to 50% in the year of introduction, then it follows that there should be an adjustment made for the DSM activities that predate the date of introduction. In particular, Union claimed that half of the 1998 DSM program savings for which it had not made any claim should be included in the DSM program savings for 1999. In the Board's view, the DSM effect from 1998 is or should be in Union's 1999 forecast. The Board does not accept that the use of the 50% simplifying assumption necessitates or indeed justifies the inclusion in the LRAM balance of savings associated with DSM programs existing prior to 1999. In establishing the PBR plan, the Board specifically adopted 1999 as the base year for the plan as well as the base year for the DSM program. The Board also notes that the E.B.R.O. 499 Decision approved the LRAM to start in 1999.

#### *The Clearance of the LRAM Balances*

**212** 2.172 The Board finds that if a DSM target is embedded in rates for a particular year, then

the appropriate method to keep the utility revenue neutral with respect to all savings would be to record the variance between the actual savings and the embedded target. For DSM activities for which a target is not embedded in the rates, then the appropriate method to hold the utility harmless would be to record all the margin impacts of the incremental DSM program volume savings in the LRAM target.

**213** 2.173 The main issue centred on whether the calculation of 1999, 2000 and 2001 rates included DSM savings embedded in the 1999 base year. The 1999 rates were approved in EBRO 499 and those rates and the related 1999 volumes formed the basis for future rates under the trial PBR plan.

**214** 2.174 Very considerable effort was expended in this proceeding in attempts to find a definitive answer to the question as to whether the rates calculation for 1999 included a reduction in volumes attributable to DSM program savings targeted for 1999. Unfortunately the evidence did not serve to conclusively resolve the point, nor does there appear to be any means by which this point can be finally resolved at this point in time. The Board notes that the original evidence filed in the EBRO 499 proceeding clearly indicated that adjustments were made to the volume forecasts to incorporate target DSM program savings. However the Board also notes that the volume forecasts upon which the final rates were established were the result of an ADR process which changed the methodology used to establish the underlying volume forecast and that Union's witness testified that no adjustments were made to incorporate the volume reductions resulting from the DSM program savings in calculating the final rates. It appears that there may have been an oversight on Union's part. If it was not in the Board-approved volumes for 1999, it should have been.

**215** 2.175 The Board notes CAC's support for an LRAM as a mechanism to keep the utility revenue neutral with respect to DSM. This revenue neutrality is important where a utility is implementing programs designed to serve a broad societal goal related to the preservation of resources and the preservation of the environment.

**216** 2.176 While the record is not definitive, it appears that if the forecast reductions attributable to the 1999 DSM programs were not included in the final calculation of 1999 rates, the Board would not want to penalize the utility for this oversight.

**217** 2.177 The Board notes Union's acknowledgment that some impact of the 1999 DSM program would have been implicitly reflected in the calculation of the trend decline in the NAC used in the calculation of the volume forecast using the ADR methodology. The Board believes that the adjustment to the LRAM balances should reflect the fact that declines due to DSM programs were experienced over the two years 1996 and 1997, rather than five years as proposed by Union.

**218** 2.178 Therefore the Board finds that the DSM savings implicitly in rates is 2.5 times the \$438,000 amount calculated by Union. The LRAM Deferral Account balance will be reduced by \$1,095,000 in each of the three years of accumulation.

**219** 2.179 The Board also accepts that no adjustment was made to account for incremental DSM savings achieved in 2000 and 2001. The Board therefore finds it appropriate for Union to recover the margins associated with DSM volume savings attained in both 2000 and 2001 calculated on this basis.

**220** 2.180 The LRAM account balances must be recalculated before disposition to reflect the Board's decisions above.

#### *Disclosure of Information*

**221** 2.181 The Board believes failure to produce documentation on the grounds of "confidentiality" should be limited to those few instances where it is necessary to protect legitimate interests of a regulated utility.

**222** 2.182 The Board believes that a full and frank disclosure generally facilitates expedited proceedings and subsequent decisions. The Board expects Union to be more forthcoming on this matter, except where there are demonstrable negative impacts on the utility. The Board notes that in the latter case, the Board has provisions under its "Rules of Practice and Procedure" for dealing with this situation.

#### *The Future Format of DSM*

**223** 2.183 The Board heard considerable comment respecting the format and efficacy of the DSM program as it is currently implemented under the trial PBR plan. The Board believes it is timely to conduct a review of the DSM program in preparation for the next generation of a PBR plan if a subsequent PBR plan is authorized. The Board requests Union to submit a proposal for a form of review of the DSM plan wherein the views of all interested parties could be represented. The Board undertakes to facilitate such a review and to make reasonable efforts to accommodate it.

### **3. DEFERRAL ACCOUNT BALANCES, DISPOSITION, AND ACCOUNT CHANGES**

#### **3.1 ACCOUNT BALANCES AND DISPOSITION**

**224** 3.1 With the exception of the costs associated with the Alliance and Vector transportation contracts, included in the Other Purchase Gas Costs Deferral Account (179-68) and the DSM Lost Revenue Adjustment Mechanism Deferral Account (179-75), parties accepted Union's updated balances and proposed method of recovery for the fiscal 2000 and 2001 deferral account balances. Union's updated evidence shows that the balance of all deferral accounts as of December 31, 2000, comprising "Gas Supply", "Storage and Transportation", and "Other" deferral accounts is \$75,813,000; with interest accruing, the balance as of December 31, 2001, is \$79,633,000. The corresponding balance of all such 2001 deferral accounts as of December 31, 2001, is \$124,851,000, including interest for 2001. The total of all such deferral accounts to be recovered for 2000 and 2001, is thus \$204,484,000, including interest on those balances to December 31, 2001.

**225** 3.2 In RP-1999-0017, Union proposed allocating the 1999 year-end deferral account credit balances of \$94,289,000 to the corresponding 2000 year-end deferral account debit balances. In the Board's Interim Rate Order in RP-1999-0017, issued October 16, 2001, Union was directed to reduce the balance by \$8,356,000 to \$85,933,000, to reflect variances in respect of rates charged to customers during the period January 1 to October 31, 2001. No other balance adjustment was authorized by the Board. With interest accruing to December 31, 2001, this total deferred customer credit balance has increased from \$85,933,000 to approximately \$95,300,000.

**226** 3.3 The balance of approximately \$95,300,000 as at December 31, 2001, has been credited to the delivery and gas supply transportation related deferral accounts and to the gas supply commodity related deferral accounts as follows: a credit of \$47,002,000 to the delivery and gas supply transportation related deferral account balances and \$56,678,000 to the gas supply commodity related deferral accounts. The Board mandated adjustment of \$8,356,000 is made to the delivery and gas supply transportation related deferral account balances.

**227** 3.4 Union proposed to collect the cumulative impact of the 2000, 2001 and 2002 delivery and gas supply transportation rate variances and the 1999, 2000 and 2001 delivery and gas supply transportation related deferral account dispositions from general service customers as a one time charge. According to Union, the total of the net accumulated delivery and gas supply transportation rate variances and deferral account balances, less the 1999 credit of \$47,002,000, is \$109,779,000. Union proposed to recover this balance using a one time charge calculated individually for such customers based on the customer's service records from the beginning of 2000, rather than use a prospective method of recovering the outstanding balances. For typical residential customers consuming 2,900 m<sup>3</sup> per annum the impacts as proposed by Union would be one-time charges of \$102.57 for Rate 01 customers in the Northern and Eastern Operations Area, and \$117.81 for M2 customers in the Southern Operations Area.

**228** 3.5 After applying the 1999 credit of \$56,678,000, the outstanding combined balance of the gas supply commodity related deferral accounts shows a credit balance of \$8,974,000, resulting in small credits to both Union's 01 and M2 typical residential customers, purchasing system gas, as follows: for Rate 01 customers, a net credit of \$5.81 for 1999, 2000 and 2001; for Rate M2 customers a net credit of \$1.43 for 1999, 2000 and 2001.

**229** 3.6 Union originally proposed recovery of these amounts prospectively through a rate rider approach. However, Union amended its proposal to be a one-time billing adjustment, noting that its impact could be mitigated if new rates were approved by the Board for implementation by August 2002, a month in which gas consumption is very low and for which equal billing customers will likely receive credit due to the past winter being warmer than normal. Union was concerned that the cumulative impact of the gas supply commodity-related deferral account disposition balances and delivery and gas supply transportation related deferral account dispositions would be large.

### ***Board Findings***



**230** 3.7 Although, in its Decision and Order (EB-2001-0788) authorizing the January commodity price adjustment in accordance with the Board-approved Quarterly Rate Adjustment Mechanism ("QRAM"), the Board expressed concern about the magnitude of the risk management costs incurred during the latter half of 2001, and its affect on gas supply deferral account balances, there is no evidence on the record in this proceeding that would suggest that the risk management costs were improperly incurred by Union.

**231** 3.8 However, the Board is concerned at the magnitude of the cumulative total balance of the deferral accounts outstanding as of December 31, 2001, which, even after the large credit related to 1999, has accumulated to about \$100,000,000, subject to adjustments required elsewhere in this decision such as related to LRAM. The Board understands that new rates will not be implemented prior to November 1, 2002. Interest charges continue to accumulate during 2002 so that the outstanding deferral account balances to be reflected in the final rate order will be even higher. Union will be seeking to recover these balances, along with amounts related to the 2001 and 2002 distribution rate increases, at a time when customers will be receiving gas bills reflecting the onset of colder weather.

**232** 3.9 The Board considers the amount to be recovered from customers as a one-time charge to be high. For Union's rate M2 customers, evidence is that the amount will exceed \$120 when the accrued interest for 2002 is included. The Board has considered two options for disposition of the amounts in question.

**233** 3.10 The Board has previously allowed Union to offset forecast deferral account balances by charging a temporary rate rider on the volumetric service provided. The Board has therefore considered allowing Union to recover customer balances resulting from clearing both the deferral account balances, and the distribution revenue shortfall of existing rates from approved rates for 2001 and 2002, by using rate rider(s) commencing November 1, 2002.

**234** 3.11 In the Board's view, on average, such a rate rider should be designed not to exceed ten percent of a customer's gas supply charges. This would reduce the immediate hardship associated with a one-time lump sum recovery. Although this would not strictly track the recovery to consumption in the period in which the amounts to be recovered arose, for many customers, it would give a fair result. The extent of the tracking would depend on the extent to which the customers to whom the rate rider is charged remain the same as the customers on the system when the variances arose and to the extent that they have the same consumption relative to other customers.

**235** 3.12 Some ratemaking practitioners have said that retroactively imposing rates or prices different from what has already been charged is to be avoided, thereby permitting customers to know the rate or price they pay before paying it. There are many examples in utility ratemaking in which rates are designed to recovery past costs, but are only charged prospectively.

**236** 3.13 Nonetheless, some retroactive ratemaking has been permitted over short periods of past

consumption, during periods when rates were declared interim.

**237** 3.14 Union has proposed to recover the deferral account balances through one-time charges based upon each customer's volumetric consumption in 2001 and 2002, thus giving rise to the typical residential customer impacts identified above.

**238** 3.15 The Board is prepared in this case to defer to Union's judgement with respect to what would be acceptable to its customers.

**239** 3.16 The Board therefore approves Union's proposed calculation of a one-time charge based on each customer's 2000 and 2001 consumption data. In the Board's view, Union should permit customers an election to pay this amount over a period of some months. For a typical M2 customer, the average monthly impact could then be reduced.

**240** 3.17 The Board takes notice that Union has recently informed its customers that the charge to recover these deferral account balances will be payable in three installments. In the Board's view, under the circumstances, customers should be given an opportunity to spread the payment over at least three installments. The company may well want to consider extending the period beyond three months.

**241** 3.18 Union is directed to explain the charges related to deferral account disposition in the customer information notices submitted for approval with the draft rate order.

## **3.2 CHANGES TO EXISTING DEFERRAL ACCOUNTS**

**242** 3.19 Union proposed to make changes to the Deferred Customer Rebates/Charges Deferral Account (179-26), the Lost Revenue Adjustment Mechanism Deferral Account (179-75) and the Other Purchased Gas Costs Deferral Account (179-68). The Lost Revenue Adjustment Mechanism Deferral Account was addressed in the Settlement Agreement and the changes were accepted by the Board.

### **3.2.1 Deferred Customer Rebates/Charges (179-26)**

**243** 3.20 Union proposed to modify the Deferred Customer Rebates/Charges Deferral Account (179-26) to include deferral charges and rebates uncollected after normal collection procedures have been followed. The account is presently used only to record small deferral account disposition amounts for customers who had received a final bill and to record unsettled amounts for customers which can no longer be located.

**244** 3.21 LPMA objected to the proposed change on the grounds that the non-recovery of deferral account balances should be considered a bad debt expense. LPMA submitted that Union was aware of the 1999 and 2000 deferral account balances for some time, but chose to leave the balances until the CRP.

**245** 3.22 VECC opposed the proposed change on the grounds that Union should be responsible for its own business risks. VECC asserted that Union is proposing to recover costs that are the responsibility of the utility under the Board-approved price cap.

**246** 3.23 CAC submitted that Union is effectively seeking a new deferral account and that Union has a bad debt expense included in rates and should manage the risk of non-recovery.

**247** 3.24 IGUA submitted that Union is compensated for risks associated with bad debt through its rate of return. IGUA submitted that there was no evidence related to the approval of a non-routine adjustment and therefore the proposal should be rejected.

**248** 3.25 Kitchener submitted that Union's proposal is not an appropriate change for introduction in the middle of a PBR term.

**249** 3.26 Schools opposed Union's proposal and identified it as a new deferral account. It pointed out that the PBR plan rates were based upon a bad debt charge of \$3.0 million and Union provided no forecast as to the quantum of the bad debts in 2002.

**250** 3.27 TCG also opposed the proposal, saying that Union could have brought forward an application to dispose of the 1999 and 2000 deferral account balances before the CRP.

#### ***Union's Reply***

**251** 3.28 Union's reply indicated that the deferral account was created to maintain risk neutrality when disposing of deferred charges or refunds. The deferred charges are three years of accumulated charges. According to Union, the proposal is entirely consistent with its purpose of allowing Union to remain financially neutral with respect to the disposition of deferred charges or rebates.

**252** 3.29 Union claimed that the charges in question are different from bad debt charges and therefore not part of Union's business risk. Since it has not had approval to bill customers for these charges, Union has been unable to manage the business risk. Union claimed that apart from the 1999 deferred charges, it did not have the discretion to deal with the 2000 and 2001 deferral accounts prior to the current proceeding.

#### ***Board Findings***

**253** 3.30 The Board is not persuaded that the proposed change to the deferral account is justified. The Board recognizes that Union may be faced with an increase in the number of uncollectible accounts due in part to customers having left the system during the past two years, but who can still be located and against whom action can be taken. This, however, remains a business risk that Union's shareholders are expected to bear.

**254** 3.31 Accordingly, the Board finds that no change should be made to the Deferred Customer Rebates/Charges Deferral Account (179-26) at this time.

### **3.2.2 Other Purchased Gas Costs Deferral Account (179-68)**

**255** 3.32 Union proposed two changes to the Other Purchased Gas Costs Deferral Account (179-68). The first relates to the method of gas storage inventory revaluation described and agreed to in the Conference Report.

**256** 3.33 The other change relates to direct purchase customers who have exceeded the maximum allowed variance at the contract year-end. Union proposes to charge these customers the difference between its WACOG and the highest Dawn-delivered gas price in the month following the contract expiry as identified in the Canadian Gas Price Reporter, for contracts that expire between October 31, 2000 and October 30, 2001. Thereafter, Union proposes that the charge reflect the highest Dawn-delivered gas supply price in either the month of expiry or the following month whichever is higher. The additional revenues collected from the surcharge in excess of WACOG would be credited to the Other Purchased Gas Costs Deferral Account. The determination of this issue is dealt with in section 2.2.

**257** 3.34 Currently these charges are applied at the time that Union disposes of its deferral account balance. Union proposes that this charge be treated as a predisposition of a deferral account and billed to an out-of-balance customer as soon as the charge is determined.

#### ***Intervenors' Positions***

**258** 3.35 VECC argued that the direct purchase customers should not rely upon the system gas supply portfolio to provide their gas supply needs for balancing. System sales customers pay for the gas procurement and not the direct purchase customers. Therefore VECC supports Union's proposal.

**259** 3.36 CAC supported the change proposed by Union but had concerns at the retroactive impact for some customers. It suggested that given the surge in gas prices customers would not have expected such large price adjustments. CAC submitted that the change should not be applied retroactively, but applied prospectively.

**260** 3.37 IGUA submitted that while customers drafting gas from the system should pay an amount in excess of WACOG, the penalty should not be excessive. Where Union is not required to purchase additional supplies to balance contracts, the amount to be charged should be "commensurate" with the charges reflected in current rate schedules, as per T1 and T3 which are Storage and Transportation rates and R30 which is Intermittent Gas Supply Service and Short Term Storage/Balancing Service. IGUA further submitted that penalties should be introduced prospectively and not retroactively.

**261** 3.38 Kitchener submitted that Union's proposal was not appropriate for mid-term of the PBR. It also claimed there was a lack of evidence of "material need".

**262** 3.39 Schools argued that Union's proposal are "unnecessarily punitive provisions". Union's balancing cost should be the incremental cost of gas purchased, thereby ensuring that Union's other customers do not pay more. Union should be directed to defer the proposed retroactive penalty charges from November 1, 2001 to November 1, 2002 and to advise its customers the change.

**263** 3.40 TCG does not support Union's proposal for retroactive charges to customers who did not balance during the period October 31, 2000, through to the implementation of new rates. There is no cost-based rationale or need for the penalties. The incentive provided by the penalty will have no impact on decisions already made. TCG also took issue with the interest that Union is proposing to collect on the outstanding charges.

### ***Board Findings***

**264** 3.41 The Board will allow the Other Purchased Gas Cost Deferral Account to be adjusted to reflect the inventory revaluation methodology agreed to in the Settlement Agreement. The tax rate used to determine amounts posted to this deferral account in respect of inventory carrying costs is resolved by the Board's decision in section 5.1.

**265** 3.42 In respect of the issue of Failure to Balance penalties, the Board has determined in section 2.2 that any penalty charges shall not be introduced retroactively. Union shall provide a restatement of this account as of December 31, 2001, to reflect the disallowance of any penalties that have been charged to this account under the new policy. Disposition of the revised balances in this account will be subject to the satisfaction of the Board's Energy Returns Officer that the revised balances are appropriate and reflect the decision of the Board.

### **3.3 DEFERRAL ACCOUNTS TO BE CLOSED**

**266** 3.43 Union provided the following list of deferral accounts which the Board in RP-1999-0017 approved for closure upon disposition of the December 31, 1999 balances: Spot Gas (179-81), Compressor Fuel Gas (179-83), TCPL Tolls (179-84), Centra Transmission Holding Tolls (179-86), Centra Pipelines Minnesota Tolls (179-87), Transportation Capacity Assignment (179-88), TCPL Variance Charges (LBA) (179-98), Energy Balancing (179-38), Ten Year Market Review (179-54), Municipal Tax (179-59) and Tax Impact of A&G Expenses (179-66).

**267** 3.44 In addition Union is now proposing the closure of three additional accounts upon disposition of their balances.

#### **3.3.1 CIS Affiliate Payment Deferral Account (179-57)**

**268** 3.45 Union had previously proposed that the CIS Affiliate Payment Deferral Account (179-57) be closed upon the disposition of its balance as at December 31, 1999. The Board, however, directed that the account continue to record the difference between Union's actual payments and the amounts included in rates to December 31, 2000. A credit balance of \$2.1 million

is recorded for 2000 and Union proposes that the account will be closed upon the disposition of this balance.

### **3.3.2 Direct Purchase Revenue and Payments Deferral Account (179-60)**

**269** 3.46 Union originally anticipated that the Delivery Commitment Credit ("DCC") would be eliminated and the elimination of the Direct Purchase Revenue and Payments Deferral Account (179-60), which includes variances in the payment of the DCC, would occur in April 2001 with the introduction of unbundled services. Union anticipated that the account would be closed upon the disposition of the 2001 and 2002 balances.

**270** 3.47 In light of the Board's decision in section 6.4 concerning the elimination of the DCC, the Direct Purchase Revenue and Payments Deferral Account (179-60) will not be closed. However, disposition of balances as at December 31, 2001, should proceed. The allocation of these balances is dealt with in sub-section 3.5.

### **3.3.3 Year 2000 Costs Deferral Account (179-61)**

**271** 3.48 As at December 31, 2000 the amount in the year 2000 Costs Deferral Account (179-61) exceeds Union's actual spending on the Year 2000 issue by \$3.0 million, including interest. Union will have no further expenditure on this issue and proposes to close the account with the clearance of the 2000 year-end credit balance.

#### ***Board Findings***

**272** 3.49 The Board confirms the closure of the following accounts upon their disposition, as previously approved by the Board in the RP-1999-0017 Decision: Spot Gas (179-81), Compressor Fuel Gas (179-83), TCPL Tolls (179-84), Centra Transmission Holding Tolls (179-86), Centra Pipelines Minnesota Tolls (179-87), Transportation Capacity Assignment (179-88), TCPL Variance Charges (LBA)(179-98), Energy Balancing (179-38), Ten Year Market Review (179-54), Municipal Tax (179-59) and Tax Impact of A&G Expenses (179-66).

**273** 3.50 Union is directed to provide a schedule accompanying the draft rate order showing the total balance of these deferral accounts, recognizing accrued interest.

**274** 3.51 The Board approves the closure of the CIS Affiliate Payment Deferral Account (179-57) upon the disposition of the December 31, 2000, credit balance of \$2.2 million, recognizing accrued interest.

**275** 3.52 The Board approves the closure of the Year 2000 Costs Deferral Account (179-61) upon the disposition of the December 31, 2000, credit balance of \$3.0 million, recognizing accrued interest.

**276** 3.53 In light of the Board's decision in Section 6.4 regarding elimination of these DCC, the

Board does not approve the closure of the Direct Purchase Revenue and Payment Deferral Account (179-60). However, the Board approves the disposition of the balance in the deferral account as of December 31, 2001, recognizing accrued interest. The deferral account shall continue until the Board approves the elimination of the DCC.

### **3.4 PROPOSED NEW DEFERRAL ACCOUNTS**

#### **3.4.1 Pipeline Integrity Deferral Account (179-Y1)**

**277** 3.54 Through the ADR process, the parties agreed to propose the establishment of the Pipeline Integrity Deferral Account (179-Y1) to cover the incremental costs arising from a new Ontario regulation related to pipeline integrity. The parties agreed that the resulting costs should qualify as a non-routine adjustment for rates commencing in 2002. All issues related to the cause and prudence of the costs will be reviewed when Union subsequently seeks disposition of the balance in the account.

#### ***Board Findings***

**278** 3.55 The Board approves the establishment of the Pipeline Integrity Deferral Account (179-Y1) to cover the incremental costs arising from the Ontario regulation. However, Union is cautioned that the approval of the establishment of such an account does not imply that all such deferred costs will be collected from ratepayers. Union will need to convince the Board that all costs charged to the deferral account are indeed incremental and result from Union's new obligations to meet the requirements of the regulation.

### **3.5 ALLOCATION OF BALANCES - GAS SUPPLY AND NON GAS SUPPLY RELATED**

**279** 3.56 The Conference Report identified as unresolved issues in this category: the allocation of the Direct Purchase Revenue and Payments deferral account (179-60) and the allocation of the Transportation and Exchanges deferral account (179-69).

**280** 3.57 Union proposed to allocate the balances in the Direct Purchase Revenue and Payments deferral account for 2000 and 2001 to rate classes in proportion to the Dawn-Trafalgar design day demand, as has been done previously. Several intervenors argued that the balances should be allocated on the same basis as the DCC elimination is done so that if DCC were eliminated as Union has proposed on a basis which is revenue neutral by class, the deferral account balance should be allocated in the same manner.

**281** 3.58 Union's evidence is that balances in the Transportation and Exchanges deferral account (179-69) have been allocated in proportion to available capacity provided by customers, having regard to contracted demand and actual throughput. This method has been approved for use in previous cases and Union is simply applying the allocation method applied in those previous cases.

**282** 3.59 During the CRP conference Kitchener raised a concern with respect to the allocation of the margin earned from the sales of transportation capacity that may have become available as a result of direct purchase customers that did not opt to take advantage of the 20% system wide delivery point flexibility option. IGUA argued that the balances should be allocated to rate classes in a manner consistent with how balances in this deferral account have been allocated to rate classes in the past. In reply argument, Union noted that no parties opposed Union's proposed disposition methodology.

**283** 3.60 In the Board's understanding, under the current rationale for the DCC program, the costs of the program have been allocated to rate classes on the basis of Dawn-Trafalgar design day demand and, on that basis, the cost variances in the DCC program have been allocated in the same way. In the Board's view, to the extent that the existing allocation of costs of the DCC program has merit, there is merit in Union's proposal for the allocation of these cost variances on disposition. Disposition of these balances should not be delayed. The Board finds that the balances should be allocated according to the existing rationale and practice, as proposed by Union, and that the account should remain open until the issue of the elimination of the DCC is effected.

### **3.6 INCREMENTAL UNBUNDLING COSTS DEFERRAL ACCOUNT (179-101)**

**284** 3.61 In the recent Decision with Reasons issued July 31, 2002, in the proceeding "Unbundling Services and Rates for Small Volume Customers" ("RP-2000-0078", 2002 LNONOEB 6), the Board approved Union's recovery of the cost forecast of \$15.7 million to enable the unbundling of rates to service the small volume market. Of the total amount, the Board directed Union to recover the costs associated with the first phase, being \$7.5 million, on a volumetric basis from all customers on the Union system. The Board further approved recovery of the second phase costs of \$8.2 million to be recovered on a transaction basis from customers in rate classes 01, 10, and M2.

**285** 3.62 Evidence submitted in RP-2000-0078 indicated that as of December 31, 2001, Union would have incurred the full first phase costs of \$7.5 million and also \$7.5 million of the second phase costs.

**286** 3.63 For the purpose of this Decision, Union is directed to dispose of these amounts as recorded at December 31, 2001, in the manner approved in the RP-2000-0078 Decision from the Incremental Unbundling Costs Deferral Account, recognizing accrued interest. The deferral account will be required to continue, so that the second phase costs incurred in 2002 may be recorded as they are incurred and considered for disposition later.

## **4. INFLATION FACTOR DETERMINATION**

**287** 4.1 The price cap index for specifying annual rate changes, before pass through adjustments and non-routine adjustments is "I-X" where I represents annual inflation and X is the input price differential plus a productivity offset. The inflation factor I must be determined annually. The issue



in this CRP concerns the appropriate inputs for the determination of the inflation factor to be applied to Union's rate schedules according to the formula established in RP-1999-0017.

**288** 4.2 Union cited Paragraph 2.248 of the RP-1999-0017 Decision: "The Board finds that the inflation factor should be determined annually. For the purpose of determining the annual price cap index, the Board adopts the use of an annual inflation escalator based on a year-over-year growth for four quarters of actual data, published by Statistics Canada for the Canadian Chain Gross Domestic Product Price Index ." Union interpreted this to mean the Board's intent was to express year-over-year inflation over four quarters of data which would be known at the time of a normal CRP rate filing.

**289** 4.3 Union observed that the Board made the initial determination of the inflation factor on the basis of a comparison between the second quarter result reflected in the GDPPI in the base year (1999), with the second quarter result reflected in the GDPPI for the following year (2000). This comparison resulted in an inflation factor of 3.9%. Union proposed to use the same methodology throughout the period of the PBR plan.

**290** 4.4 Regarding StatsCan revisions to the published GDPPI, Union argued that since there is no reason to believe that StatsCan revisions would be biased upwards or downwards, any such revisions would be "a wash" and need not be considered from a substantive point of view. Further, Union asserted that parties might advance strategic proposals, i.e., base their positions on whether or not to adopt updated data based on the effect the data has on the I-factor.

### ***Intervenors' Positions***

**291** 4.5 LPMA noted that, in interrogatory response C20.6, Union stated: "The Board, in its RP-1999-0017 Decision, approved the use of the most recent GDPPI available during the normal scheduling of the annual Customer Review Process."

**292** 4.6 LPMA disagreed with Union's interpretation as to which data the Board had approved for use in the determination of the price cap. LPMA's view was that "[t]he Board approved the Inflation factor for use in the price cap formula for 2001 using the most recent data that would have been available for the GDPPI if the price cap had been set in October during a CRP."

**293** 4.7 LPMA added that for years 2002 and 2003, the Decision in RP-1999-0017 does not indicate whether the data used for the price cap should be either the data that would be available at the time when a "normal" CRP should be held, that is in the early fall or, alternatively, the data available when the CRP is actually held. Further, it submitted, the Decision in RP-1999-0017 does not stipulate that the Q2 over Q2 change in GDPPI is to be used for 2002/2003.

**294** 4.8 LPMA rejected Union's position that the Board had unequivocally established that the second quarter over second quarter methodology would be used no matter when the CRP was to be held.

**295** 4.9 LPMA submitted that the appropriate base GDPPI for a PBR plan from 2001 to 2003 is the GDPPI at 2000 Q4.

**296** 4.10 LPMA argued that its approach is less biased than Union's approach since LPMA's approach implies a rate of inflation over the last 18 months of the PBR period that is closer to the inflation experienced over the first 18 months of the plan.

**297** 4.11 LPMA distinguished between an annual percent change ending in the second quarter of a year, i.e., the change in the average of four quarters of data compared to the average of the previous four quarters, and a year-over-year percent change at a given point in time, i.e., the change in GDPPI from its value four quarters prior. LPMA submitted that the Board had approved the latter methodology in RP-1999-0017.

**298** 4.12 LPMA stated that in the RP-1999-0017 proceeding, the issue surrounding the inflation factor was whether a fixed forecast for the PBR term or annual forecasts should be used. LPMA submitted that the Board had approved the use of the GDPPI as a forecast of the inflation rate.

**299** 4.13 LPMA added that the Board's use of a year-over-year change in the GDPPI implied that the GDPPI was used as a forecast of inflation as opposed to reflecting an annual rate of inflation: had the latter been the Board's intent, the Board would have used an annual price calculation and would have included a true-up. LPMA concluded that "the Board methodology cannot reflect the actual inflation over the term of the PBR period."

**300** 4.14 LPMA submitted that in the event that the Board approved Union's approach with respect to the use of the GDPPI, the Board should direct Union to use the revised 2001 Q2 GDPPI value of 106.8: this implies a 2000 Q2 - 2001 Q2 increase of 2.0% [= (106.8 - 104.7) / 104.7] and hence a price cap of -0.5% for 2002 (representing a price cap decrease in base revenue of \$3.649M). LPMA argued that it was consistent to use revised GDPPI data citing Ms. Elliott's testimony that the 2000 Q2 figure used by the Board would have been a revised figure.

**301** 4.15 LPMA added that while the cumulative impact on Union would be the same whether an unrevised or a revised datum were used, use of the revised figure would bring forward some of the (otherwise 2003) inflation, thereby partially mitigating the impact of other dispositions and retroactive charges in 2002.

**302** 4.16 LPMA's position was that the Board intended the GDPPI to be used as a forecast. LPMA's submission was that if the Board agrees that its intention was to use actual GDPPI as a forecast, then the Board, in using the GDPPI for forecasting near term inflation, should utilize the most recent information available at the time of the Board's decision. LPMA disputed Union's position that the information available at a "normal", i.e. an early fall, CRP should be used.

**303** 4.17 VECC disagreed with Union's proposal to use the year-over-year change in the Q2 GDPPI for the 2002 price cap, submitting that using only Q2 data for successive years ignores price

levels in all other quarters. VECC submitted that "Union's proposal elevates the mechanics of a one time Board calculation into a permanent principle for inflation adjustment."

**304** 4.18 VECC argued that since Union's input purchases are not restricted to Q2 of each year, a Q2 - Q2 year-over-year change does not appropriately reflect "annual prices."

**305** 4.19 VECC stated that the most recent information should be used for every forecast, noting that under cost of service, Union would update volume and gas cost filings as new information became available. VECC supported the use of the change in the annual average GDPPI from one year to the next to determine the I-factor.

**306** 4.20 VECC echoed LPMA's comments that regardless of the methodology approved by the Board for the I-factor calculation, the most up to date data should be used; if the Board accepts Union's proposal, the revised StatsCan data should be used; and, the 2002 price cap would then be -0.5% for a base revenue reduction of \$3.649 M.

**307** 4.21 CAC, noting that Union's experts had stated that the inflation factor used in the price cap should reflect the inflation over the term of the PBR plan, asserted that Union's inflation factor proposal would not accomplish this. Rather, "[t]he adjustment for 2001 captures the higher inflation experienced in the period preceding the PBR term." CAC submitted that if Q2 - Q2 changes are made throughout the plan, the adjustment to rates could not equal the actual inflation over the term of the plan.

**308** 4.22 CAC submitted that "[t]he I-factor attempts to provide a proxy for what actual inflation might be for a prospective period ...". As such, CAC, citing the Board's Decision argued that for the I-factor, the most recent data available should therefore be considered, as it is superior to less recent data.

**309** 4.23 As an alternative, CAC submitted that the Board, under the assumption that a 2003 CRP would be held this fall, could use consistent data going forward by choosing year-over-year changes based on Q3 results to calculate the I-factors for 2002 and 2003.

**310** 4.24 IGUA argued that the issue was the appropriateness of using a measure of inflation of 2.5% for year 2001 over year 2000 when, according to the GDPPI data for 2001 and 2000, the actual increase is 1.1%. IGUA submitted that it would be unjust and unreasonable to use an inflation that is 2.3 times the actual increase.

**311** 4.25 IGUA stated that the Board's use of 2000 Q2 over 1999 Q2 data, which produced an I-factor of 3.9% for 2001, was reasonable insofar as "the actual annual inflation for 2000 over 1999 turned out to be 3.7%."

**312** 4.26 However, IGUA argued that the same methodology, year-over-year 2000 Q2 - 2001 Q2 results in an I-factor of 2.5% while the actual annual increase in GDPPI from 2000 to 2001 is 1.1%.

As such, IGUA stated that the year-over-year Q2-Q2 methodology is not a reasonable proxy for actual inflation and should not be used.

**313** 4.27 IGUA responded to Union's allegation that the position of some intervenors in this matter (i.e., to use a different inflation proxy for 2002 rates than was used for 2001 rates) was "opportunistic" and "biased", submitting that "the objective is to establish rate levels for 2002 which reasonably estimate the extent to which inflation increased in 2001 over 2000."

**314** 4.28 IGUA noted that under Union's proposal, declines in GDPPI in 2001 would be reflected in 2003. IGUA submitted that given the significant deferral account debits proposed to be recovered from customers in 2002, the IGUA proposal would better serve the public interest as the reflection in 2002 of the GDPPI decline would partly mitigate the deferral debits.

**315** 4.29 Kitchener submitted that "... the Board intended the GDPPI to be used as a forecast, not an actual measurement of the year over year change in inflation. Secondly, ... the Board expected the forecast to be based on the most recent evidence available, when the CRP occurs."

**316** 4.30 Kitchener added that Union's evidence in RP-1999-0017 always recognized the I-factor as forecast growth in inflation and that both Union's evidence and the Board's Decision in RP-1999-0017 "contemplated an adjustment to the price cap in advance of the year for which rates would be set.". It went on to assert that the Board's reference to a price index data series was to be used as "a forecast" of the economy's behaviour and that the Board's methodology for the 2001 I-factor was a forecast based on the most recent data, not necessarily Q2 to Q2. It argued: "[T]he Board's use of Q2 to Q2 for 2001 was done for the purpose of providing a concrete illustration to the parties under the then most likely scenario of setting the I-factor in October of any year during a CRP. As noted, Q2 to Q2 was not mandated as a component of the Board's methodology".

### ***Union's Reply***

**317** 4.31 Union noted that when the Board set the 2001 I-factor, the Board used a year-over-year, 1999 Q2 - 2000 Q2, methodology, even though full year GDPPI data for 2000 was available. Therefore, Union submitted, the Board's decision with respect to the I-factor required no interpretation. The Board clearly intended that the same Q2 over Q2 methodology should be used throughout the term of the plan.

**318** 4.32 Union contended that "[t]he Board rejected the use of forecasts in favour of actual data. And the Board rejected the use of most recent data in order to establish the basis for *ex ante* rate making without having to change the methodology in midstream and having to deal with all of the distortions attendant thereon."

**319** 4.33 Union submitted that the Board had neither spoken nor acted on an intention to forecast inflation for the coming year or to establish a proxy for average annual year over year change. Union noted that for 2000 the Board did not use an annual average methodology even though the

data was available. Union also questioned why the Board would have used Q2 as a proxy for year end data when the Q4 data was available and why the Board would have used "... Q2 data to "forecast" anticipated inflation in the coming year when sophisticated forecasts from DRI and others were available and on the record."

**320** 4.34 Union also submitted that the Board used Q2 data as "... it best met a number of competing objectives ..." whereas the use of 2000 actuals or forecasts would present ongoing problems in a multi-year plan: requisite actual information would not be available if rate setting were on schedule but if, "due to regulatory or other delay for example", actuals were available one year "... they would not be available in the next year, thereby creating problems of inconsistency in measurement."

**321** 4.35 Union argued that to set rates in advance, the Board would have to use either historic actuals or forecasts and that the Board chose actuals.

**322** 4.36 Union stated that, if the intervenors' argument is correct and it was the Board's intention to forecast inflation using the most recent data available, then the Board was wrong to use Q2 over Q2 for 2000 since the methodology did not use the most recent data available in July 2001.

**323** 4.37 Union submitted that the reason that the Board did not use actual inflation during the PBR plan for the I-factor was to avoid retroactive rate adjustments (since actual inflation would never be known in advance). "The only way to perfectly capture inflation for any year in the price plan is to abandon any notion of avoiding retroactivity and simply treat inflation impacts on a deferred basis."

**324** 4.38 Union argued that while there was no reason to prefer either the year over year Q2 to Q2 methodology or the average year over year methodology to the other, the evidence indicated that a change in methodology that results in ignoring two quarters of data and double counting two other quarters of data "... will not produce a better, more accurate or fairer measure of inflation."

**325** 4.39 Union added that the Board's Decision on Union's Motion to Vary the RP-1999-0017 Decision stated, "... because the PBR regime involves a synthesis of many elements, the correction of one element may well involve a reconsideration of the synthesis itself." Since there has been no initiative to review the PBR plan as a whole, Union stated that the Board must reject midstream plan changes.

**326** 4.40 Union contested IGUA's argument that the rate setting methodology should be changed to mitigate the impact of deferral account settlements by stating that deferral account balances are unrelated to the issue of the appropriate methodology to set the I-factor for 2001 - 2003. Union argued that "[i]t would be in excess of the Board's jurisdiction and contrary to the rules of natural justice for the Board to change the methodology it has already approved, with all of the problems and unfairness attendant thereon, for the sole purpose of keeping rates lower just because, for completely unrelated reasons, there happens to be large deferral account debits to customers."

**327** 4.41 Union concluded that there was no ambiguity in the Board's Decision in RP-1999-0017 regarding the I-factor. Union urged the Board "... to reaffirm, clearly and unambiguously, what the Board has already decided about the methodology for measuring inflation during the term of the plan." Union submitted that this reaffirmation would put an end to litigation and strategic positioning over this issue.

### ***Board Findings***

**328** 4.42 In the RP-1999-0017 Decision the Board approved a methodology which was designed to provide a framework for the initial trial period of PBR for Union. A key element in the PBR approach involves the establishment of rates in advance of the year in which they will be charged. Part of the overall structure of Union's PBR was the CRP, which was to occur in the fall of each year of the PBR Plan, so as to define the applicable rates which would come into effect the following January.

**329** 4.43 In the Board's view, in developing a methodology for the determination of the I-factor for the initial trial period for Union's PBR plan, if rates are to be set in advance of their applicability, with a practical minimum of debate and litigation, the inflation factor would have to be determined on the basis of prior periods. Insofar as the Board had determined that the fall of each year of the Plan was the appropriate time frame for the Customer Review process, it is necessary to establish criteria for determination of an inflation factor which can be easily determined at the time of the annual CRP and which, in part by using consistent data sets from one year to the next, provides a prospect that anomalies in the inflation figures would even out over the course of the PBR plan, and from PBR plan to PBR plan.

**330** 4.44 Accordingly, the Board finds it appropriate to use a comparison of the actual inflation figures year-over-year for the second quarter as it is published and available at the time the CRP decision is made for the succeeding year, as a basis to determine the I-factor in the PCI. This means that StatsCan revisions to its second quarter figures may be used if they are available at the time of decision.

**331** 4.45 When establishing the I-factor for the second generation PBR plan, if such there be, the Board may be persuaded that some other methodology may provide a better means of determining inflation for application in the rate adjustment formula. The same may be said with respect to other elements of the PBR plan. The Board is also mindful of the consideration that adjustments to the PBR price adjustment formula in mid-course should be rare and should be approached with caution.

**332** 4.46 The PCI for 2001 shall reflect an inflation factor of 3.9%, as determined in RP-1999-0017. The PCI for 2002 shall reflect an inflation factor of 2.0%.

## **5. PASS-THROUGH AND NON-ROUTINE ADJUSTMENTS**

### **5.1 ONTARIO INCOME TAX AND TAX RATE FOR INVENTORY CARRYING COST**

**333** 5.1 There are three issues addressed by intervenors concerning the role of Ontario income taxes in Union's rates over the PBR term. One issue is whether the Applicant should be compelled to make a one-time non-routine adjustment to the price cap element of the PBR formula to reflect the fact that Ontario corporate income taxes have decreased over the last two years of the trial PBR plan.

**334** 5.2 A second issue is the interpretation of the Board's decision in RP-1999-0017 as it concerned a \$900,000 reduction in the revenue requirement for Union arising from tax decreases which had been fully implemented in May 2000. Thirdly, there is a question as to the tax rate to be used in the calculation of deferral accounts, most particularly, the deferral account created to capture the carrying costs related to inventory of gas. The Board will deal with the later two issues at the conclusion of this section of the Decision.

**335** 5.3 The Board's Decision in RP-1999-0017 did not dispose of the issue as to whether material changes to corporate taxation rates should be treated as mid-term Z-factor adjustments or conversely, could be considered to be captured and reflected in the GDPPI as part of the overall economic environment.

**336** 5.4 Instead, the Board required Union to "track the effect of changes in the Ontario Income Tax, and to bring forward the cost changes to be considered through the CRP as an adjustment to rates." The Board expressed some doubt that tax changes applicable only to Ontario would be adequately reflected in the GDPPI.

**337** 5.5 The Applicant asserts that the decreases in corporate income taxes are captured in the GDPPI, which has been selected by the Board as the index to be used in ascertaining the inflation factor relevant to the PBR formula, and that no non-routine adjustment should be made. Some intervenors have suggested that the decreases in Ontario income tax cannot be presumed to have been incorporated in the GDPPI, at least not within an appropriate time frame, and that the decreases should be dealt with as a non-routine adjustment. It has also been suggested that the fact that the GDPPI is a national index, reflecting national price fluctuations, blunts its efficacy as a reflection of specific Ontario tax reduction measures.

**338** 5.6 In response to the Board's direction Union presented expert evidence to the effect that the Ontario Tax changes outlined in the various filings have been, or are likely to be reflected in the GDPPI. In their opinion, all tax adjustments which are of general application within Ontario find their way into indices such as the GDPPI sooner or later. The experts testified that such changes in tax rates, as are part of the record in this case, are reflected in such indices either prospectively, or after a lag period: prospectively, insofar as the economy reacts to tax changes upon the announcement by the provincial government of its intention to change tax rates; and after a lag, when effects of the tax changes work their way through the economy after enactment.

**339** 5.7 The experts testified that the reflection of changes in tax rates in indices such as the GDPPI is even more certain when the tax change affects a significant portion of the national

economy, and when like changes are being implemented in numerous jurisdictions across the nation. The Ontario economy represents a very significant portion of the overall Canadian economy which is reflected in the GDPPI and Ontario corporations are responsible for over 40% of the corporate profits generated in Canada. The experts suggested that this fact makes it likely that the national index, the GDPPI, will reflect the Ontario changes in corporate tax rates.

**340** 5.8 Further, they noted that numerous other jurisdictions in Canada had made reductions in tax rates over the relevant period. In their view, this widespread reduction in tax rates across the country makes it very likely that the index would reflect this aspect of the economic environment.

**341** 5.9 Union submitted that the danger of permitting or requiring it to approach changes in tax rates through the Z factor mechanism is that such adjustments would lead to a double counting of the changes to the extent that they were already reflected in the GDPPI.

**342** 5.10 Union offered examples from other regulatory contexts in which the regulator determined that only tax changes which uniquely or disproportionately affect the utility should be treated as a non-routine adjustment. Union submitted that the rationale for this approach was that the economy-wide price index reflected general tax changes and thus, to treat general tax changes as a Z-factor would be to double count their effect.

**343** 5.11 Union stated that the experience of other regulators showed that attempting to account for lead and lag effects of tax changes in economy-wide price indices would require reflection of not only current tax changes in present and future price caps but also the impacts of past tax changes in present and future price caps. Union also suggested that there was no recognized or reliable methodology to measure lead or lag effects.

**344** 5.12 Addressing the issue that the change was in provincial income tax rates, while the GDPPI reflects national price fluctuations, Union's experts stated that four-fifths of corporate profits are earned in three provinces, each of which is reducing corporate income tax rates in comparable degrees. Therefore, the economy-wide GDPPI would be significantly affected by these simultaneous reductions and "... there is no basis for an adjustment."

**345** 5.13 Union also asserted that attempting to correct the price cap for leads or lags would induce strategic behaviour and litigation thereby reducing the simplicity of setting the price cap.

### ***Intervenors' Positions***

**346** 5.14 IGUA, VECC, and Schools urged the Board to consider that Union had not provided a sufficient evidentiary basis for its position that the decreases in Ontario tax rates would be reflected in the GDPPI. They also asserted that the national nature of the GDPPI and the complexity of lead and lag effects of such tax changes obliged Union to provide more detailed evidence on each of these aspects of the issue.



**347** 5.15 These intervenors also asserted that the issue was not open and had been definitively decided by the Board in its Decision in RP-1999-0017. Based on their interpretation of portions of the PBR decision, the Board decided in that case that tax changes such as those implemented in Ontario during the course of the PBR must be dealt with as non-routine adjustments.

**348** 5.16 While LPMA accepted Union's position that the GDPPI should be presumed to capture some portions of tax changes going forward, it asserted that adjustments should be made for tax impacts (i) that were known and in place prior to the PBR plan and (ii) that are not reflected in the GDPPI, having arisen too late for inclusion in that index at the relevant time.

**349** 5.17 LPMA asserted that while the Union experts testified that the impact of 2000 tax changes would affect GDPPI in future years, LPMA noted that a portion of the tax decrease took effect in the second quarter of 2000, which was the quarter used to calculate the I-factor for the PBR plan. There is no evidence, they suggest, that the tax decrease arising in the second quarter of 2000 was captured in any degree in the GDPPI at that time. In fact, they suggest that it is very unlikely that those reductions had been accounted for in the GDPPI at that time. VECC made a similar submission.

**350** 5.18 LPMA disputed the Union contention that the 2000 tax reduction was passed through at the start of the PBR plan, arguing that only part of the reduction -- not the full annualized amount -- was treated thus. LPMA submitted that all changes prior to the plan should be accounted for on an annualized basis. This is especially so, it asserts, since the tax reductions applied to Ontario only, and took place in May 2000. LPMA also submits that by Union's own testimony, had the change occurred at the beginning of 2000, it would likely have been reflected in 2000 base rates.

**351** 5.19 LPMA noted that, according to Union's expert testimony, the current price level decrease was driven by lower export and energy prices. LPMA suggested that parties jointly investigate using data other than GDPPI data for a second generation PBR term.

### *Union's Reply Argument*

**352** 5.20 Union repeated its position that any leads or lags with respect to the reflection of provincial tax changes in the GDPPI are "empirically undeterminable". Further, any price cap adjustments made in the year following the tax change would have to be later reversed to avoid double counting but "[t]here is no reliable way to determine when and how these adjustments should be made and reversed."

**353** 5.21 Union disputed the claim, made by some intervenors, that the Board had already decided that changes to Ontario corporate income tax should be Z-factored, asserting that relevant paragraphs in the RP-1999-0017 Decision must be read in context.

**354** 5.22 As to whether Ontario tax changes are reflected in GDPPI, Union submitted that all of the experts agreed, and no party led evidence to the contrary, that tax changes are generally

reflected in the GDPPI. Union added that no intervenor took issue with the three precedents cited in Union's argument-in-chief, all of which found that non-routine adjustments made for tax changes under a price cap amount to double counting. Union stated that "[o]n the evidence, the Board can come to no other conclusion but that changes to corporate income tax are reflected in the GDPPI."

**355** 5.23 Union noted that Kitchener, LPMA, and WGSPG agreed with Union that Ontario tax changes are reflected in the GDPPI and that whether there are lags or leads is unverifiable.

**356** 5.24 Union asserted that Ontario's corporations earn approximately 43% of Canadian corporate profits, and that, if Ontario were the only jurisdiction changing its corporate tax rates, the reduction might not be fully reflected in Canadian GDPPI. However, they noted that in 2001, each of the federal government, Quebec, New Brunswick, and Alberta -- in addition to Ontario -- lowered taxes; and that in 2002, British Columbia, Manitoba, and Ontario lowered taxes with further reductions planned for Alberta, Manitoba, Quebec, and Ontario. Further, Union stated that the Ontario tax changes were not out of proportion with the other tax changes. The other tax decreases offset the "dilution" of the Ontario tax changes in the GDPPI.

**357** 5.25 Regarding the "lead/lag issue", Union noted that Kitchener, LPMA, and WGSPG accepted its evidence. Union added that there was no evidence on what the lead or lag is or on how one would adjust for it and later reverse the adjustment. Incorporating lag effects, Union submitted, would require assessing the impacts of past as well as current tax changes.

**358** 5.26 Union addressed the position of some intervenors that the second quarter to second quarter methodology "adopted by the Board" to determine the inflation factor will not reflect in the price cap for the following year any tax changes occurring after the second quarter of a given year. Union argued, however, that with announced tax rate changes, there can be a lead effect that causes the tax change to be reflected in the GDPPI before it is implemented.

**359** 5.27 Union stated that "[t]o the extent that the intervenor argument is correct, however, ... it is equally correct for every other cost that Union is exposed to." Union argued that once tax changes are accepted as "endogenous" to the price cap, there is nothing unique about leads or lags associated with tax changes; the same issue is present for increases and decreases in wages, interest rates, exchange rates, federal tax rates, and payroll taxes. Union submitted that cost consequences which are immediate for Union may not flow through in rates until a following year.

**360** 5.28 Union submitted that tracking changes, adjusting base rates, and later reversing the adjustments would add cost and complexity to address a need that was "questionable."

### ***Board Findings***

**361** 5.29 There may be instances where a tax change is of such a nature that it may warrant treatment as a Z factor. Such a case may arise when a tax change is of such special and unique application to Union that it could not reliably be expected to be reflected in a Canada-wide index

such as the GDPPI. It may also be true that the parties, when assessing the current PBR plan and designing its successor, will want to consider alternate methodologies for determining the inflation factor.

**362** 5.30 The Board notes that the use of an actual GDPPI, which the Board has chosen for expediency and to avoid significant debate within a CRP, means accepting that changes in other costs too may have a lag affect on rates. Its fairness over time would appear to rely on consistently using the same approach, including consistently choosing comparable data on which to base the I-factor determination.

**363** 5.31 The Board accepts for now that the changes in the Ontario corporate tax rates are or will be reflected in the GDPPI, and that no Z factor adjustment should be made at this time with respect to the rate schedules currently in effect under the PBR plan. The income tax changes, therefore, are to be considered to be captured in the determination of the PCI.

**364** 5.32 In respect of the second issue relate to taxes, the Board notes that the Applicant has not implemented the Board's direction to decrease its base revenue by \$900,000 to reflect the adjustment of corporate income tax which took effect in May 2000 and which is necessary to determine an appropriate base from which to go forward. That direction appeared in paragraph 2.169 of the RP-1999-0017 Decision with Reasons.

**365** 5.33 An adjustment of this type is necessary in order to make the base in 2000 "normal" for the future period when rates will be in effect. Union has suggested that because the Board asked it to track changes in corporate income taxes for presentation and consideration by the Board in its future assessment of the acuity of the GDPPI in capturing tax changes, it decided to delay or forego the implementation of the Board's direction.

**366** 5.34 The Board repeats its direction to Union to adjust its rate calculations to reflect the reduction in the revenue requirement represented by the \$900,000 referenced in Paragraph 2.169 of the PBR decision. This direction should be implemented forthwith. In the future, the Board expects that the Applicant will seek early clarification from the Board with respect to any apparent direction which the Applicant seeks to defer or forego.

**367** 5.35 As the LPMA has pointed out, the adjustment should be "annualized" to reflect the tax cost going forward. Accordingly, Union is directed to ensure that the adjustment reflects a twelve month affect.

**368** 5.36 The other tax-related issue involves the selection of the appropriate rate to use when determining inventory carrying costs. Union's gas inventory is a component of working capital and therefore a component of rate base which underlies the determination of the base rates for the PBR period.

**369** 5.37 The value of the inventory changes as the price of gas changes. The Board in

RP-1999-0017 allowed the pass-through of "price" variances related to the change in the price of gas to Union from the price that was reflected in base rates. Such variances were to be "price" variances only. Such variances include price variances related to gas consumed in operations, but they also include variances in the carrying costs of gas inventory held by Union for its utility operations. These inventory carrying costs are included in rates over the PBR term in the same manner as the "carrying costs" of all other items in rate base, i.e. they are determined by the "return" on rate base. The equity return is the equity return that was allowed by the Board in base rates for the PBR term, the debt rate is the debt rate that was allowed by the Board in base rates, and a tax rate. For all other items of rate base, including other elements of working capital, the tax rate comes from the tax rate which the Board allowed in base rates, which is the tax rate prevailing at the end of the year 2000. A number of intervenors submit that the tax rate should essentially vary and be kept current. As Union has pointed out in this proceeding, allowing a changing tax rate would lead to an increase in costs to be passed through, and it would also constitute varying more than the price of gas, notwithstanding that the Decision in RP-1999-0017 called only for a pass-through of costs related to the price variance.

**370** 5.38 For consistency in the treatment of this and other rate base items in the cost of service model underlying the base rates for the PBR term, the Board accepts that the appropriate tax rate to use in calculating the inventory carrying cost "price" variance is the tax rate permitted in the other return calculations.

**371** 5.39 For greater certainty, however, to preclude carrying the consistency beyond what the Board considers appropriate for this calculation, just as Union has not increased the other return components of this calculation by the PCI, the Board believes it would be inappropriate to increase the tax rate used in this calculation by the PCI.

## **5.2 WEATHER NORMALIZATION**

**372** 5.40 Union originally proposed to implement a new weather normalization methodology effective January 1, 2001, with a one-time non-routine rate adjustment of \$13.6 million. Union later informed the Board that it no longer sought the non-routine adjustment for inclusion in rates in 2001 or 2002, but that it was seeking endorsement of the new weather methodology for operational and planning purposes.

**373** 5.41 Union stated that it was not seeking any Board approval with respect to weather normalization. Therefore, there was no non-routine adjustment issue requiring disposition in this proceeding.

### ***Intervenors' Positions***

**374** 5.42 A number of intervenors took no position on this issue or regarded the matter as settled pursuant to the Settlement Agreement.

**375** 5.43 Kitchener expressed its concern that the new methodology, if implemented for operational and planning purposes, would apply to existing non-contract customers who unbundle and to existing direct purchase customers whose contracts expire, and that, upon expiration of an existing contract, a lower level of storage capacity would be allocated to such customers.

**376** 5.44 Kitchener remarked that the Board's approval of Union's method for allocating storage space is based on the Board's assessment that the outcome is an allocation that adequately meets customers' needs. Kitchener urged that the new methodology should not be implemented until the Board has conducted a "full inquiry ... to determine if the resulting allocation adequately meets the needs of customers."

**377** 5.45 Kitchener noted that although unbundling customers are being allocated less storage space, Union does not intend to reduce the allocation of storage costs to these customers. Kitchener acknowledged that space allocations could be reduced under the existing methodology but, while the Board understood this when it approved rates in EBRO 499, the Board's approval did not include the larger reduction in space allocations under the new weather normalization methodology. Kitchener submitted that this issue is therefore a rates issue and that Union should not be allowed to eliminate a cost under-pinning rates without Board approval and without the necessary rate adjustment.

**378** 5.46 Kitchener argued that the effect of the new methodology is to release the "excess" storage for sale as C1 storage, thereby transferring 25% of the margin on the sale of the "excess" to the shareholder notwithstanding the fact that the storage has been fully paid for by customers, the costs of storage being completely included in rates. Kitchener submitted that it was inappropriate to create and transfer this revenue stream to the shareholder under these circumstances.

**379** 5.47 Kitchener concluded that the "changes of significance" effected by adopting the new methodology should not be taken without Board approval. Kitchener urged the Board to direct Union to maintain the space allocations based on the old weather normalization methodology until the new methodology is reviewed and approved.

**380** 5.48 CEED submitted that unbundled customers use cost-based storage allocations to meet daily balancing obligations; should additional storage be required, it must be purchased at market rates. CEED stated that if storage allocations are too low, marketers will not be able to offer unbundled services.

**381** 5.49 CEED argued that in RP-1999-0017, the amount of storage allocated to unbundled customers was settled based on Union's representations regarding the amount of space it required for system integrity, with the remaining space allocated at cost to customers. CEED asserted that customers accepted less storage than they would have preferred in the belief that Union required the rest of the space for system integrity.

**382** 5.50 CEED alleged that Union, through the new storage allocations arising from the use of

the new weather normalization methodology, was attempting to claw back storage space, not required for system integrity, from unbundled customers for the benefit of the shareholder either through offsetting "... the cost of managing growth, or to release to the S&T group to provide additional assets for use in the sale of transactional services under the C1 rate schedule."

**383** 5.51 CEED submitted that for unbundled customers, transportation allocations were based on a mean daily volume of gas, whereas daily delivery obligations were based on daily weather algorithms: if the resulting imbalance were not remedied, the customer would face penalties. CEED argued that "[a] central way to remedy the imbalance is through access to physical storage." CEED noted that in the RP-1999-0017 proceeding, Union agreed to provide in-franchise storage space to bundled and unbundled customers at cost.

**384** 5.52 CEED argued that Union first allocated 9.1 Bcf of storage capacity to system integrity, an allocation that no party questioned, and then stated that all remaining storage space would be allocated to customers. CEED noted that unbundled customers still had to purchase supplemental storage services "at effectively unregulated rates (e.g. C1 short term storage rates)."

**385** 5.53 CEED added that unbundled customers also took a 2.4% discount from their needs based on the calculations in order to help maintain system integrity based on Union's representation that if all took unbundled storage services, there would have been an over-allocation of storage to unbundled customers, reducing the amount of system integrity storage space. In CEED's characterization, Union first proposed storage allocations based on "aggregate excess" but then adjusted the allocation to keep the 9.1 Bcf of system integrity storage space. Parties accepted this approach.

**386** 5.54 CEED submitted that Union was attempting to further reduce the storage allocations to unbundled customers because the new weather methodology impacted each customer's aggregate excess. However, CEED contended that, even though the new methodology did not affect the amount of system integrity storage space required, Union was still seeking to further reduce the space allocated to unbundled customers to the benefit of Union's shareholder either through releasing extra storage for marketing by the Storage and Transportation ("S&T") group or through using it to avoid new storage development expenses.

**387** 5.55 CEED concluded: "... Union has not provided a convincing rationale for reducing storage allocations to unbundled customers and transferring the economic value of storage to its shareholder. It is inconsistent with the factors that went into the initial storage allocations in RP-1999-0017, and should not be allowed."

**388** 5.56 CME expressed concern that while Union was not seeking any Board approval, Union was using the methodology for operational and planning purposes. CME urged the Board to "... require Union to provide evidence to interveners so that the methodology can be evaluated."

### *Union's Reply*

**389** 5.57 Union submitted that the new 20-year trend normalization methodology provides a better forecast than the 30-year average normalization methodology. Union added that, if it did not reflect the 20-year trend normalization methodology in its upstream transportation and storage planning, Union would overcontract for upstream transportation and overbuild storage. If Union uses the 20-year trend normalization methodology in its upstream transportation and storage planning but uses the 30-year average normalization methodology in allocating upstream transportation and storage to unbundled customers, the unbundled customers will have too much of these assets' services and the other customers would have too little.

**390** 5.58 Union asserted: "Weather normalization methodology is an operational business issue squarely within the purview of utility management. In Union's view, the Board does not need to approve the change in Union's planning assumption for it to be reflected in the storage allocations to unbundled customers. Union committed to providing unbundled customers access to the storage assets on the same basis that they are used to provide bundled services. Union is continuing to do so on the basis of the aggregate excess method. Parties always knew, however, that the storage allocations to unbundled customers would change to reflect the underlying aggregate excess calculations."

**391** 5.59 Union disputed Kitchener's contention that in-franchise customers have paid for the storage space made available by switching to the new methodology, stating that the new methodology highlights the fact that significant volume reductions have not been built into rates. Union argued that although "... EBRO 499 general service rates have more storage costs built into them than may now be required to support the service, they were also designed assuming higher throughput. The lost margin that results from warmer weather is much greater than the value of freed up storage. Union's witness, Mr. Packer, indicated that if everyone unbundled, the amount of storage space that would be freed up ... would only be about 2 Bcf. The margin associated ... would be significantly less than the \$13.6 million delivery revenue shortfall as a result in the change in the weather normalization methodology."

**392** 5.60 Union argued that, although the change in weather normalization methodology represented a potential shareholder benefit (of 25% of the margin in marketing the freed-up storage under the C1 schedule), it also exposed the utility to higher unabsorbed demand charges on upstream capacity if it were to overcontract base on the old formula: direct purchase customers are assigned upstream capacity according to their Daily Contract Quantity ("DCQ") and the DCQ is reset annually by Union for weather normalized customers. Under the old methodology, Union would be able to assign 4.3% more upstream capacity to these customers.

### ***Board Findings***

**393** 5.61 The Board acknowledges that Union has not sought its approval for a change in the Weather Normalization Methodology for the purpose of setting rates in this proceeding. However, it is clear that the implementation of the new methodology may have implications for a number of

aspects of its operations, including storage allocations for its customers, the opportunity for increased revenues from excess storage sales in the ex-franchise market, and the system integrity storage requirements. These operational aspects are of direct interest to the Board in fulfilling its regulatory mandate. The first and third of these relate directly to the level or quality of service provided. The Board also acknowledges that there is good reason for management to have knowledge of the results of a weather normalization method which they believe gives more accurate results, and to use it in planning and operations to the extent that it does not affect rates or service rights.

**394** 5.62 The Board accepts the view advanced by some intervenors that the current weather normalization methodology underpinned a number of aspects of the trial PBR plan put in place as a result of the RP-1999-0017 Decision. Changes such as this, as they may affect customers' current entitlements, should best be made at the time a PBR program is instituted or re-based. It is the Board's view that, at the very least, the changes attendant to a change in weather normalization deserve very careful and comprehensive analysis before they should affect changes in service entitlements.

**395** 5.63 Accordingly, the Board directs the Applicant to defer application of the proposed new weather normalization methodology, as it may affect the allocation of storage rights to customers, until such time as it brings an application forward seeking Board approval of its use and there is an opportunity to review concerns such as those of Kitchener.

**396** 5.64 The Board recognizes the issue raised by Union concerning how much upstream capacity it should contract for. In the Board's view, this may go to the question of how management should structure the mix of short and longer terms in its portfolio of upstream transportation and whether or for how long the distribution utility should be a provider (reseller) of upstream transportation to meet the needs of consumers of non system gas. If and when there are cost consequences, if not before, these questions may have to be addressed.

## **6. OTHER RATE AND RATE-RELATED MATTERS**

### **6.1 FINANCIAL REPORTING**

**397** 6.1 In section 13 of the Conference Report, parties acknowledged that a review of 2001 actual financial information and earnings sharing would be part of the 2003 CRP. However, Union agreed to file actual 2001 financial information prior to the commencement of the hearing. Although parties held the view that this information had no impact on the CRP for 2001 or 2002, the Board is interested in the 2001 financial information which Union filed.

**398** 6.2 Questions arose during the hearing as to whether or not Union was responsive to the Board's stated desire for the filing of regular financial performance information for Union's utility business as outlined in RP-1999-0017. Questions also arose as to the utility's responsiveness to longstanding agreed-upon filings with the Board's Energy Returns Officer. In addition, questions



arose as to whether the revenues and costs in the financial information for 2001, filed in this proceeding in response to the Settlement Agreement, were properly categorized as to "utility" and "non-utility". Finally, on the morning that Union was to deliver its argument in chief orally, further statements of utility income were provided and, in the Board's view, they too appeared to require further amendment or explanation.

### ***Board Findings***

**399** 6.3 Intervenors will, of course, have an opportunity again to address this financial information for 2001 in the CRP for 2003. However, the Board is concerned about the form and the timeliness of providing information that the Board addressed in its decision in RP-1999-0017. In the Board's view provision of this information for review by stakeholders and the Board is important to the success of Union's PBR scheme. In the RP-1999-0017 Decisions with Reasons, the Board's views on this matter are found at paragraphs 2.766 - 2.771, where the Board addressed rationale for the provision of information under utility regulation and particularly under a PBR scheme such as was approved for Union.

**400** 6.4 In light of the experience to date, the Board sees a need to clarify and particularize its stated requirements. However, the Board would be assisted by a report first from Union setting out how it intends to comply with the filing requirements identified in RP-1999-0017. Union is directed to prepare and file such a report before the commencement of the oral hearing in the next CRP, RP-2002-0130.

**401** 6.5 The Board notes that, in providing financial information related to utility operations all utility costs and revenues must be reported. The Board has permitted Union to earn certain amounts over and above the fair return on equity which has been determined formulaically and included in the revenue requirement for ratemaking. For example, in recent decisions the Board has permitted certain performance-based incentives such as allowing shareholders to benefit from 25% of certain incremental margins. They are earnings of the utility and must be reported as such.

## **6.2 RETURN ON EQUITY AND THE EARNINGS SHARING MECHANISM**

**402** 6.6 The original application sought a review of the ROE formula and a decision that any revision to the formula would be applied to the ESM for 2002. Union noted that a calculation of any earnings sharing for 2002 would occur in the next CRP.

**403** 6.7 On December 14, 2001, the Board issued Procedural Order No. 1 in which parties were advised that the Board would deal with those portions of the Application related to the return on equity in a separate process.

**404** 6.8 Subsequently, the Applicant indicated that it was withdrawing that portion of the Application relating to return on equity, but that it reserved the right to argue in subsequent proceedings that changes to the return-on-equity methodology or the resulting return on equity be

applied to the ESM calculations for 2002. No intervenor opposed Union's reservation of this right.

**405** 6.9 LPMA supported Union's request to defer consideration of the issue but took issue with Mr. Penny's comment that "... the application of the earnings sharing mechanism will occur in the next customer review and rate hearing process in the summer and fall of 2002." LPMA submitted that the CRP in summer and fall of 2002 would deal with earnings sharing of 2001 financial results, using a ROE of 9.66%, as per the Settlement Agreement (Issue 2.1). Also in Issue 2.2 of the Settlement Agreement, LPMA stated that "... parties agreed that the input into the equity formula for earnings sharing would be determined using actual long Canada bond yields for 2002. As this information will not be available until the end of 2002, any earnings sharing for 2002 will not take place until a customer review process or rates hearing that would take place in 2003."

**406** 6.10 VECC did not object to Union's "reservation of rights" position "... as it does not assume that the Board must act to alter the PBR earnings sharing to accommodate any change in the ROE formula."

**407** 6.11 VECC noted that the issue would not have to be addressed until 2003 (after the 2002 data is available) which will provide for a thorough review and for parties to file expert evidence.

**408** 6.12 The Board acknowledges the Applicant's withdrawal of the portion of the Application relating to the return on equity and takes note of its intention to address the subject in a subsequent proceeding, including its application to calculations in respect of the Board-approved ESM for 2002 earnings.

### **6.3 FAILURE TO DELIVER CHARGES: R1, T1, AND T3**

**409** 6.13 Union noted that under the existing rate schedules, direct purchase customers which fail to deliver according to the terms of their contracts face two penalties: a failure-to-deliver charge of \$2.31/GJ applied to all undelivered volumes, and a clawback of the DCC due to the customer for the period from the contract start date to the time of failure to deliver, to a maximum of 365 days. The rationale for clawing back the DCC in this circumstance is that the customer, in breaching its contract, has not provided the system benefit of obligated deliveries.

**410** 6.14 Union argued that the DCC payment recognizes the benefit provided by the contractual obligation to deliver, more specifically the avoided cost of not having to build additional facilities. Failure to deliver also may impose additional costs on other consumers related to Union having to replace the undelivered volumes.

**411** 6.15 Union submitted that, with the elimination of the DCC, the incentive for the customer to deliver according to its contractual obligation would be weakened. To restore the incentive to its pre-DCC elimination level, Union proposed to increase the failure-to-deliver charge.

**412** 6.16 Union proposes an increase of \$1.34 per GJ in the failure-to-deliver charge, calculated

by dividing twelve months of what would have been DCC clawback per GJ by 30. According to Union, the result is that, for each day of failure to deliver, the proposed penalty is equivalent to approximately 12 days of what would have been DCC clawback.

**413** 6.17 Union stated that it hoped the charge would never be levied and that, as is the case with respect to the failure to balance penalty, the size of the charge is intended to discourage customers from strategically failing to make obligated deliveries and imposing costs on other customers.

### *Intervenors' Positions*

**414** 6.18 Most of the intervenors supported the Applicant's proposal, and aligned it closely with the Applicant's proposal with respect to the elimination of the DCC

**415** 6.19 LPMA supported Union's proposal to increase the failure-to-deliver penalty from \$2.31/GJ to \$3.65/GJ on the R1 (Bundled Direct Purchase Contract Rate) rate schedule.

**416** 6.20 LPMA submitted that, as Union has argued, this issue is tied to the DCC elimination. LPMA stressed "... that this failure to deliver penalty as a replacement for the DCC clawback further emphasizes the need to eliminate the DCC based on the allocated costs, and not on the payments. The contractual obligations to deliver, along with the increased penalties, provide a safety net to Union with regards to east-end deliveries."

**417** 6.21 VECC argued that with the proposed elimination of the DCC, the penalty mechanisms, historically available to Union for direct purchase customers who do not deliver, will "cease to exist."

**418** 6.22 VECC remarked that under Union's DCC proposal (to eliminate the DCC by reducing rates to according to the payments), the DCC benefits will be predominantly distributed to existing direct purchase customers in the industrial rate classes, regardless of whether they meet their delivery obligations. VECC reiterated that, for this reason, it did not support the DCC elimination proposal.

**419** 6.23 VECC argued that if the Board accepted Union's proposal regarding the DCC elimination, then the revenues collected from the failure to deliver charges should be allocated to the general service M2 rate class to offset the "cross subsidization" of the industrial rate classes by the M2 class. VECC noted that historically, DCC clawback revenues had been booked into a deferral account, thereby reducing costs of the DCC program; VECC argued that the new penalty charges should not be a component of net income to the benefit of the shareholder.

**420** 6.24 CAC supported Union's proposal to increase the failure-to-deliver charge but did not support the proposal to flow the associated revenues to the shareholder. CAC proposed that the associated revenues derived from the proposed enhanced penalty be booked into a deferral account for future disposition.

**421** 6.25 IGUA, noting the linkage to the DCC elimination proposal, supported Union's proposal to increase the failure-to-deliver penalty charge, conditional upon the approval of Union's DCC elimination proposal, which IGUA characterized as based on the provisions of the RP-1999-0017 Settlement Agreement.

**422** 6.26 Kitchener submitted that, as a general rule, the proponent of a rate change bears the onus of demonstrating the appropriateness of the proposed change. That burden, it suggests, is higher when it is proposed to make such a change in the middle of a PBR term.

**423** 6.27 Kitchener added that in its view, one goal of PBR "... is to achieve rate stability and to focus the attention of parties at the customer review process on the application of the price cap formula. It is inconsistent therefore with performance based regulation to allow Union to change the cost of using a rate schedule or to otherwise change the conditions in a rate schedule in mid-term without evidence demonstrating a material need for the changes."

**424** 6.28 Kitchener argued that Union had failed to establish through evidence that there was any need for alterations to the failure-to-deliver penalty, pointing out that with respect to the T3 Storage and Transportation rate class, no failure to deliver had occurred. With respect to the T1 Storage and Transportation rate class, Kitchener argued that there was no evidence that failure-to-deliver was a material concern.

**425** 6.29 Schools also rejected Union's proposal. It suggested that the appropriate remedy for a failure to deliver is contractual. Union's contractual remedy is to purchase the gas elsewhere, and if the cost of the purchased gas exceeds the Union WACOG, the customer would be obliged to pay the difference.

**426** 6.30 Schools also suggested that the proposed penalty is excessive, insofar as it would result in charges that are equal to or greater than commodity costs in most months over the last several years. Schools asserted that the elimination of the DCC did not in any way justify an increase in the failure to deliver penalty. DCC elimination provides no basis for an increase in failure to deliver charges since the payment for obligated deliveries is different from a penalty for breaking a contract. In the event of delivery failure, Union currently receives the incremental cost of gas plus \$2.31/GJ which, Schools suggests, is sufficient to deter opportunistic behaviour. Schools also urged the Board to conclude that there was inadequate evidence to support the Applicant's proposal. Finally, Schools rejected Union's proposal that the proceeds of the penalty should flow to the shareholder of the Union, citing a lack of evidence on this point.

### *Union's Reply*

**427** 6.31 Union repeated its submission that an increase in the failure to deliver penalty was needed as a result of the elimination of the DCC. Union submitted that there had been failures to deliver, even with the failure to deliver charge and the DCC clawback

**428** 6.32 Union reiterated that its system integrity was jeopardized when a customer failed to deliver and that it had to incur "not easily quantifiable" legal and overtime costs to remedy the difficult situation.

**429** 6.33 Union submitted that "[t]he fact that failure to deliver charges may exceed the cost of the commodity in some months or that a comparable charge does not exist in the Northern and Eastern Operations area is irrelevant. Union has experienced failures in the Southern Operations area. If the same financial incentive for customers to deliver is not maintained as existed in the past, more failures will result. There should be no dilution of existing disincentives against a failure to deliver."

**430** 6.34 Union estimated that the total DCC clawback for failure to deliver over the last two years would be \$42,000, not material or significant to Union, and not sufficient to warrant deferral account treatment since the costs of tracking incremental costs and revenues would exceed the benefits.

### ***Board Findings***

**431** 6.35 In light of the Board's decision with respect to the Applicant's proposal to eliminate the DCC in section 6.4, the proposed changes to the Failure-to-Deliver penalty are inappropriate at this time, and are not approved. The Board is mindful of the importance of parties meeting their contractual obligations to deliver commodity. Such compliance has important implications for the integrity of the gas supply system as a whole.

**432** 6.36 The Board notes that, in addition to the above mentioned incentives to meet obligations to deliver, customers having such an obligation to deliver to Union through upstream transportation systems could also face a penalty of unabsorbed demand charges on those systems. The Board will deal with the appropriate magnitude of the failure to deliver penalty when it deals with the elimination of the DCC.

## **6.4 ELIMINATION OF THE DELIVERY COMMITMENT CREDIT PAYMENT**

**433** 6.37 Union provides the DCC to those customers which manage their upstream transportation and meet their obligation to deliver in accordance with the terms and conditions of their contract with Union. The obligation to deliver allows Union to rely on these volumes being delivered, in order to manage its deliveries efficiently and to meet certain system design and security criteria. The amount of the credit has been based on avoided costs of Dawn-Trafalgar transmission and storage. Union recovers the costs of the DCC through rates charged to in-franchise customers. In RP-1999-0017 Union proposed the elimination of the delivery commitment credit in a manner that it stated was revenue neutral on a customer class basis.

**434** 6.38 Union summarized the details of the DCC proposal in RP-1999-0017 as follows:

- \* deliveries are, and will be, contractually obligated;
- \* customers managing their transportation capacity and obligations to deliver were paid the DCC;
- \* starting with EBRO 499, the DCC was calculated based on avoided Dawn-Trafalgar storage and transmission costs for 365 days of firm delivery;
- \* the DCC elimination was based on the need to accommodate the new unbundled services and the proposed delivery point flexibility;
- \* additional reasons for DCC elimination included the DCC not being well understood, the ability to close associated deferral accounts, and the fact that no other North American pipeline company maintains such a program;
- \* to minimize the impact on individual customers the 1999 forecast DCC payout to each rate class would be removed from each rate class' delivery rates;
- \* in order to accommodate the DCC elimination a range rate was proposed for M7 and T1 rate classes;
- \* marketers were not neutral to the DCC elimination since the reduction in the residential delivery rate would be less than the DCC payments made to retail energy marketers; and
- \* the rate impact of the proposed DCC elimination for each rate class was identified in the pre-filed RP-1999-0017 evidence.

**435** 6.39 In the Settlement Agreement for the RP-1999-0017 proceeding parties agreed with Union's proposal in wording which expressed revenue neutrality in terms of "all customers".

**436** 6.40 In this proceeding, some parties did not agree with the rate adjustments proposed by Union in respect of the DCC elimination, over concerns that Union's proposed implementation does

not achieve revenue neutrality and with the impacts on the revenue-to-cost ratios.

**437** 6.41 The regulatory treatment of the DCC elimination also affects the disposition of the Direct Purchase Revenue Deferral Account and the Transportation and Exchanges Deferral Account Balances.

**438** 6.42 Union stated that termination of the DCC was contemplated in the RP-1999-0017 Decision and that it was to be achieved through rate class adjustments.

**439** 6.43 Union submitted that, while the DCC payments were based on obligated delivery volumes, the costs of these payments were allocated to rate classes on the basis of design day demand. Union argued that this cost allocation was appropriate because, had the avoided facilities been constructed, their costs would have been allocated to rate classes on this basis. Union stated that variances between the amounts collected through rates to fund DCC credits and the DCC payments were recorded in the Direct-Purchase Revenue Payments Deferral Account. Union stated it had allocated the balances to classes in accordance with design day demand, "... consistent with the method previously approved by the Board and consistent with the avoided facilities costs benefits received by each rate class."

**440** 6.44 Union noted that there was a "mismatch" between the allocation of DCC costs in rates and the distribution of the payments "... because those that provide the obligated deliveries do not necessarily benefit from the avoided facilities costs or at least not in proportion to the deliveries that they make."

**441** 6.45 Union stated that although the DCC payments were being eliminated, the obligation to deliver remained. Union noted that its proposal only changed the compensation mechanism from a direct payment to customers for obligated deliveries to a rate reduction designed to be revenue neutral by class; rates for each class would be reduced by the amount of DCC payments formerly received by consumers in the class.

### *Intervenors' Positions*

**442** 6.46 LPMA and the WGSPG submitted that the RP-1999-0017 ADR Agreement provides parties the right to re-examine settled issues in a future proceeding. VECC supported this position.

**443** 6.47 LPMA and the WGSPG argued that:

- \* the DCC is not needed as a result of direct purchase customers having an obligation to deliver;
- \* the DCC program is not being eliminated under Union's proposal given that the impact of the DCC would still be reflected in rates;

- \* Union's interpretation of the RP-1999-0017 ADR Agreement is in error. Specifically, parties were not supportive of the elimination of the DCC being revenue neutral on a rate class basis but on an all customer basis;
- \* Union's proposed implementation is not revenue neutral for the M2 rate class, given that the payment that has historically been made to retail energy marketers (on behalf of the customers they serve) is larger than the resulting M2 delivery rate reduction that accompanies the DCC elimination;
- \* the way Union has proposed eliminating the DCC is invalid because no DCC was paid to system customers;
- \* based on the evidence filed in the EBRO 499 and RP-1999-0017 proceedings, they were not aware of the differences that existed between DCC payouts and recovery, and of the effect the proposed elimination would have on the revenue-to-cost ratios for customer classes;
- \* the revenue-to-cost ratios suggest that the proposal will perpetuate a "cross subsidization" among classes. While the revenue-to-cost ratio for the M2 class will be increased from 1.020 to 1.065 and the revenue-to-cost ratio for M9/T3 class will be increased from 1.002 to 1.029, the revenue-to-cost ratios for all other classes will decrease: T1 decreases from 0.803 to 0.528; M7 firm decreases from 0.894 to 0.680; M7 interruptible decreases from 0.529 to 0.2; and M5A decreases from 0.824 to 0.625;
- \* Union's proposal introduces a certain "pricing flexibility"; and
- \* the DCC should be eliminated in a manner consistent with pass-through adjustments and non-routine adjustments, which is on the basis of the Board approved cost allocation methodology from EBRO 499.

**444** 6.48 LPMA submitted that the entire DCC program should be eliminated. In its view, the most appropriate way to do so is to reduce rates based on the level of costs related to the DCC currently embedded in the rates.



**445** 6.49 LPMA submitted that Union's DCC proposal results in rates and revenues out of line with service costs, that a rate-class-based comparison of the allocated DCC costs to the DCC payments demonstrates cross-subsidization, and that this hearing was the first occasion when this had been shown. LPMA submitted that, consistent with the approach that has been taken under PBR, removal of DCC costs should be based on the cost allocations which supported the DCC payments.

**446** 6.50 LPMA stated that Union had not provided any evidence in support of the assertion by Union's witness that raising delivery rates to industrial users would lower Union's industrial load throughput. Furthermore, LPMA commented that for a large industrial customer, the delivery component of the overall gas bill is small compared to the upstream transportation and commodity components.

**447** 6.51 LPMA rhetorically questioned why direct purchase customers' deliveries to Parkway provide a system benefit while those of system gas customers do not. LPMA asserted that Union's allocation of benefits to classes according to direct purchase volume deliveries constituted a "streaming of benefits" to those classes that was inappropriate for an integrated system.

**448** 6.52 CAC and VECC submitted that the DCC should be eliminated on the basis of costs recovered through rates charged to each rate class rather than the revenue, or DCC payout, to each rate class. They commented that the DCC was rendered unnecessary by Union; that Union's proposal does not eliminate the DCC, it embeds it; and that the impact on each rate class of Union's proposed "revenue neutral" elimination was not explained during the RP-1999-0017 proceeding.

**449** 6.53 VECC interpreted the Board's RP-1999-0017 Decision to mean that the DCC costs currently included in rates should be eliminated. VECC distinguished between revenue neutrality based on an individual end-use customer's perspective from revenue neutrality in reference to all end-use customers, supporting the latter interpretation, which it claimed requires that the Union remove the embedded DCC costs of \$27.261M from rates.

**450** 6.54 VECC remarked that the DCC originally had nothing to do with obligated deliveries or the Dawn-Trafalgar system, but rather it had to do with the difference between the buy/sell price and Union's WACOG. VECC stated that it was not until the EBRO 499 Settlement Agreement that Union proposed that the DCC be associated with avoided costs of the Dawn-Trafalgar system. VECC commented that had this change gone to hearing as opposed to having been settled through the ADR process, it was possible that not all parties would have endorsed the change. VECC therefore disputed Union's statement that all parties were agreed on the revised methodology.

**451** 6.55 CAC stated that the notion of what constituted a revenue neutral removal was in dispute. CAC submitted that eliminating the DCC should be accomplished by removing the DCC costs from the cost of service on the basis of how the costs are allocated to the rate classes. CAC argued that Union's proposal does not eliminate the DCC, it merely embeds its costs in rates.

**452** 6.56 CAC acknowledged that Union did present evidence regarding its DCC proposal in RP-1999-0017 but argued that rate impacts by class were not in evidence.

**453** 6.57 CAC argued that the revenue-to-cost ratio analysis demonstrates unfair levels of the cross-subsidization, mainly by the M2 rate class, embedded in Union's proposal. CAC remarked that all customers are obligated to deliver and all customers benefit from these obligated deliveries. CAC suggested that Union's concern that elimination of the DCC, based on removal of costs, would have considerable negative impact on certain customer classes (for example T1 and unbundled M7 customers), could be mitigated by phasing the changes in over a two-year period.

**454** 6.58 IGUA submitted that if the Board is not prepared to endorse eliminating the DCC in accordance with the provisions of the RP-1999-0017 ADR Agreement, which is what Union has proposed in this proceeding, then the DCC should not be eliminated.

**455** 6.59 IGUA commented that the DCC payment to direct purchasers who obligated to deliver their daily contract volumes (DCQ) to Union, 365 days a year, "... was a by-product of the advent of direct purchase as an alternative to the acquisition of system gas from Union." IGUA submitted that this commitment by direct purchase customers results in avoided facilities savings for Union; the Board recognized these savings and determined that compensation was appropriate. IGUA stated that "it would be completely unreasonable and in contravention of the provisions of the ADR Agreement" to revert to a rate setting approach that predated direct purchase. IGUA argued that the direct purchasers' commitment to deliver DCQ to Union continues to provide a system benefit and should be recognized; failing that, the DCC should be reinstated.

**456** 6.60 Kitchener urged the Board to direct Union to eliminate the DCC program entirely, by eliminating both the credit payments and the associated class revenue requirement, in order to uphold the ADR Agreement in RP-1999-0017 and to avoid unjust and unreasonable rates. Kitchener opposed Union's DCC elimination proposal on the basis that Union's proposal eliminates only the credit, not the DCC program; it does not achieve revenue neutrality; and it does not result in just and reasonable rates.

**457** 6.61 Kitchener observed that the failure to deliver issue was not created by system gas customers. Therefore having the DCC program, and its proposed elimination result in M2 customers permanently subsidizing direct purchase customers is unreasonable.

**458** 6.62 Kitchener acknowledged that the evidence in RP-1999-0017 indicated that the DCC would be eliminated by reducing the delivery commodity charge of each rate class by the amount of the DCC credit received, but stated that there was no indication of the cross-subsidization that would be created and no mention that DCC costs would be left in rates after the removal of the DCC program.

**459** 6.63 Kitchener acknowledged that, while the benefit of obligated deliveries will continue, the cost of the DCC program will be gone after eliminating it; contractual commitments combined with

non-delivery penalties will achieve the benefits of firm east-end deliveries.

**460** 6.64 Kitchener argued that Union's proposal represents the value of firm deliveries as a cost. Kitchener submitted that this proposal -- to assign values to benefits achieved without costs and to subsequently allocate the values among rate classes as if they were costs -- is a "dangerous and aggressive basis" for rate setting for an integrated system such as Union's, where each class benefits from the presence of other classes. Kitchener added that allocating benefits as if they were costs when there are no associated costs was unfair to captive customers "who have no competitive alternatives and therefore little or no bargaining power."

**461** 6.65 Schools urged the Board to direct Union to rework its proposal and resubmit it in the next CRP. Schools recommended that the DCC should be eliminated in a way that removes the DCC costs from rates. Schools argued that Union's proposal was unacceptable, noting that the average school would lose \$582 annually in DCC payments but would only get a delivery rate reduction of \$127 per year.

**462** 6.66 Schools noted that most of the DCC credits of \$27.257M accrue to the large volume M7 and T1 classes but that the bulk of the costs have been assigned to class M2. Schools further noted that during the time that the DCC was paid, Union moved system gas on TCPL FT to Parkway yet did not propose, and in the DCC elimination proposal is not proposing, to recognize an avoided cost benefit on behalf of system gas customers. Schools disputed Union's position with respect to the rate impact on M7 and T1 rates of eliminating the DCC costs by class, arguing that for such customers delivery rates account for only 5 - 10% of the bill and a 35% delivery rate increase gives rise to only a 2.5% increase in the gas bill. Schools argued that cases of hardship for M7 and T1 customers that arise should be dealt with on a stand-alone basis.

**463** 6.67 Schools noted that Union's proposal to eliminate the DCC was based on (i) the DCC not being well understood, (ii) continuation of associated deferral accounts being incompatible with the PBR plan, and (iii) the program's uniqueness to Union. Schools found reasons (i) and (iii) "hardly compelling".

**464** 6.68 Schools questioned the fairness of Union reducing demand charges for M7 and T1 customers to exactly offset the loss in DCC revenue, yet failing to do likewise for school boards and other mid-sized customers.

**465** 6.69 Schools argued that the "cross subsidies" demonstrated by the revenue-to-cost ratio analysis shows that the proposal is unfair. Schools urged that the DCC costs should be removed from the rate classes that have supported the DCC for the last twelve years.

### *Union's Reply*

**466** 6.70 Union asserted that it had filed extensive evidence detailing precisely how the DCC would be eliminated and that parties had the benefit of an extensive formal discovery process in

RP-1999-0017. Union also submitted that there has been no change in circumstances with respect to either the system benefits provided by obligated deliveries or payment to customers for obligated deliveries to justify revisiting this issue.

**467** 6.71 Union submitted that the only change to Union's DCC proposal that was made in the RP-1999-0017 Settlement Agreement was change the date of DCC elimination to April 1, 2001. Union emphasized that its objective was to minimize the impact on customers, not to "unwind" the recognition of system design benefits due to obligated deliveries.

**468** 6.72 Union acknowledged that, under the proposal, there would not be revenue neutrality for all customers in the M2 class. Union stated that this was due to the fact that the rate reduction to all M2 customers was based on a DCC payment made only to direct purchase M2 customers, but submitted that this was known at the time of the RP-1999-0017 Settlement Agreement.

**469** 6.73 Union elaborated that the DCC payout, based on a 365-day obligation, would be difficult to continue with the new unbundled service offering and its 22-day obligation. However, Union argued that the 22-day call obligation would still provide system benefits similar to those afforded by the 365-day call obligation and Union had recognized this through its proposal to roll the payout customers would otherwise have received into rates. Union insisted that the RP-1999-0017 reference to the DCC being unnecessary is a reference to the DCC payment, not to the system design benefit. Union remarked that if it could not eliminate the DCC to align with the new unbundled service, it would continue to pay the DCC for the trial PBR term; this would result in essentially no net costs to most customers.

**470** 6.74 Union noted that evidence regarding the system benefits of obligated deliveries was provided in EBRO 499 and that this evidence was accepted by all parties to the EBRO 499 Settlement Agreement. Union asserted that there was no evidence in the current proceeding (i) that obligated deliveries do not confer system benefits or (ii) that the DCC payments do not reflect the benefits provided by obligated deliveries.

**471** 6.75 Union also argued that eliminating the DCC such that revenue-to-cost ratios are kept close to 1 is not revenue neutral and therefore contrary to the RP-1999-0017 Settlement Agreement. Union stated that the reason the DCC revenues and costs are allocated differently is due to the difference between those providing the system benefits and those receiving the system benefits.

**472** 6.76 Union disputed LPMA's contention that the DCC proposal introduces pricing flexibility, arguing that the proposal preserves what has been in place for years and which the Board has found to result in just and reasonable rates.

**473** 6.77 Union stated that it should be a matter of grave concern to all parties and the Board that, a number of parties are seeking to resile from or to reinterpret the agreement reached in the RP-1999-0017 settlement process.

**474** 6.78 Union contended that if the Board does not accept the DCC proposal, "... it can only be on the basis that there was no agreement on this issue. In that event, the DCC cannot be eliminated at all. Union supports the submission of IGUA on this issue."

### ***Board Findings***

**475** 6.79 The DCC in its current form and rationale was introduced in 1990 as a result of the Board's Decision in EBRO 462. In fact, the payment has its origins as compensating direct purchase customers for obligating to deliver their gas to Union at a constant rate each day of the year (i.e. at an annual load factor of 100%) consistent with the way in which system gas was delivered to Union in the Southern delivery area and the way in which the distribution system and storage operations had been planned for and operated. There is no similar payment to direct purchase customers on the EGDI system.

**476** 6.80 The DCC structure was extended to buy-sell customers as a result of the Board's Decision in EBRO 493-04/494-06. Once again, in approving the extension of the DCC, the Board directed Union to present at the next main rates case a thorough review of the DCC and alternatives to it. In EBRO 499 Union filed evidence on the DCC; the issue was dealt with as one of the matters subject to an overall settlement proposal of parties which the Board accepted for purposes of that proceeding.

**477** 6.81 Throughout its existence, the DCC has been structured so that payments were made to direct purchasers meeting their delivery commitments, and the corresponding compensating costs were allocated to all in-franchise rate classes. The allocation of the costs of the DCC program was based on an understanding that the delivery by the participating large users and according to their obligation spared the system, as a whole, facilities expansion costs which would have otherwise been incurred. In the RP-1999-0017 ADR there was complete settlement on the elimination of the DCC.

**478** 6.82 Although the DCC may have been necessary in the early years of gas commodity competition in Ontario in order to encourage direct purchasers to assume the risk of arranging their own upstream transportation, questions have been raised as to whether firm deliveries of system gas in the Southern delivery zone do not also provide similar benefits to system integrity and efficiency. Furthermore, in an integrated distribution system, with local storage, all deliveries at 100% load factor may in fact benefit all customers. Economic penalties for failure to ship on upstream transportation systems at 100% load factor may also be a significant encouragement to ensure constant daily deliveries so that other penalties or rewards may no longer be required or may be reduced. Union's evidence is that contractual obligations and failure-to-deliver penalties can provide sufficient incentive without the need to continue payment of the DCC as well.

**479** 6.83 What is at issue, however, is who are the principle beneficiaries of the deliveries at 100% load factor and who should bear the costs of any incentives to ensure such deliveries. Clearly, the burden of shipping at less than 100% load factor on upstream systems falls on the respective

shippers; similarly, the payment of failure-to-deliver penalties falls on any direct purchaser which fails to deliver to Union's system in accordance with its contractual commitments and the terms of Union's rates schedules. Union's proposal to eliminate the DCC would continue to impose a cost burden recovered through rates on the small volume customer classes and continue to provide a cost reduction to large volume customer classes. Whether this distribution of perceived burdens and benefits is justifiable on the basis of load factor criteria and sound economic rationale requires a more thorough review of cost analyses, cost allocation methodologies, and the principles of designing rates and tolls for transportation, storage and delivery.

**480** 6.84 The ADR Agreement specified that the DCC should be discontinued on a basis which would be revenue neutral to all customers. Revenue neutrality may be at the customer level, the class level, or in aggregate. The ADR agreement is not clear on this point, although Union's pre-filed evidence set out its proposal on the basis of revenue neutrality at the customer class level.

**481** 6.85 While the Board is reluctant to stray from the terms agreed to in an accepted settlement agreement, the Board notes that in this case there appear to be differences of view among the parties to the Settlement Agreement in RP-1999-0017 as to the meaning of "revenue neutrality". The wording of the agreement would itself indeed permit more than one interpretation of how revenue neutrality is to be satisfied. Furthermore, Union and IGUA, both support retention of the DCC in its current form, absent the elimination under the terms of revenue neutrality proposed by Union.

**482** 6.86 The Board therefore finds it appropriate to defer the elimination of the DCC until Union brings forward a proposal that addresses the issues and concerns as stated above and an implementation plan. If the rate impact of discontinuing an allocation of "credit" to the large industrial classes would be large enough to materially affect gas deliveries to large customers, the proposal should address a phasing out of the credit program over time.

**483** 6.87 The Board notes that on this issue it has again encountered a disagreement among parties on the interpretation of an ADR agreement as it did in RP-2000-0078. The Board reminds parties that it is incumbent on them to ensure that the wording of the agreement accurately reflects what they have agreed.

## **6.5 PROPOSED RATE SCHEDULE CHANGES**

### **6.5.1 T1/T3 Diversion of Gas and Gas Supply Charge for Negative Storage**

**484** 6.88 Union has proposed to change the description of the diversion of gas service in the T1 and T3 rate schedules "to provide more clarity and consistency" with the Act.

**485** 6.89 Union has also proposed to change the unauthorized storage space overrun charge applicable to T1 and T3 customers when their storage balances fall below zero. Union has proposed that the charge be changed to be consistent with the proposed charge to bundled direct purchase customers that do not balance within 4% at contract renewal as identified at Section 11.2. For

customers that do not provide their own deliverability inventory, the unauthorized storage space overrun charge would apply to each GJ of gas below a zero inventory level. For customers that provide their own deliverability inventory, the zero inventory level would be deemed to mean 20% of annual firm storage space. If the customer's contract has a provision that ratchets down (reduces) the customer's withdrawal right when the amount of gas in their contracted firm storage space is less than 20%, then the zero inventory level would be zero (i.e. not 20% of annual firm storage space).

### *Intervenors' Positions*

**486** 6.90 IGUA submitted that Union has relied on its proposal to change the charges to bundled direct purchase customers who do not balance to within contractual tolerances in order to justify a similar change to the T1 and T3 rate schedules, and that Union's proposal should be rejected on the basis that there is no evidence to justify the change because T1 and T3 customers have not abused their obligation to balance. In IGUA's view the penalty provisions of the rate schedules have been approved for operation under the 3-year PBR Plan and ought not to be changed during that term.

**487** 6.91 Kitchener opposed the proposed rate change arguing that there is no evidence to support the need for the change in the T3 rate class. Kitchener opposes the proposed wording changes on the basis that the proposed wording changes remove rights currently available to Kitchener to divert gas to parties outside of Union's franchise area and within storage at no charge.

**488** 6.92 VECC supported the proposed changes to gas supply charges for customers with negative storage balances and the crediting of these charges to gas supply deferral accounts.

**489** 6.93 Union argued that there would be no revenue generated from customers through the negative storage balance charge if customers were abiding by the contractual terms of the services they have elected to take. However, according to Union, at least one customer has found it economic to let its storage balance go below zero because it was more economic for it to do so when supply prices has peaked than it would have been to bring in incremental supply. Union submitted:

"Penalty charges are fundamentally different from Union's ordinary rates. They are, generally, not cost-based and include no consideration of return to the shareholder. Their purpose is quite different. In the interests of system integrity and the greater good of all customers, they are designed to discourage certain types of behaviour. There is no issue of "managing" the associated costs within the price cap. Accordingly, it is appropriate to change penalty provisions in the middle of a PBR plan, if there is new evidence that the existing provisions are not instilling the required market discipline. The proposed change provides absolutely no shareholder financial benefit (Vol. 3, para. 222). All charges generated from the proposed change will be credited to the Other Purchased Gas Costs deferral account."

**490** 6.94 Union stated that the new charges would at times be higher than the old, but not necessarily. In Union's submission, the new charges would more accurately reflect the market alternative available to customers, and when gas prices spike, Union does not have time to file a proposal with the Board to remove an incentive for customers to behave in an inappropriate manner.

**491** 6.95 Union argued that the evidence does not support Kitchener's claim that Union's proposed wording changes remove rights currently available to them. In Union's current understanding and practice, diversions that occur upstream of Union are not diversions in which Union becomes involved, and there is no such thing as a "diversion" within storage.

### ***Board Findings***

**492** 6.96 In the Board's view, the penalties must be sufficient to ensure that there is no economic incentive for a customer to operate outside of the stated parameters for the service, and sufficient to dissuade such operation. Union must be able to plan and operate its system with the knowledge that its customers will generally operate within the set parameters. The penalties at the same time must not be of unreasonable magnitude. The penalty revenue will be credited to the Other Purchased Gas Costs deferral account, not to the credit of the shareholder. The Board accepts the proposed modifications to the unauthorized storage space overrun charge.

**493** 6.97 With respect to the wording change which is of concern to Kitchener, and the related issue of title transfer of gas, the Board does not understand the rationale for permitting customers of some rate schedules to effect title transfers in storage while customers on other rates must have the gas deemed to have been removed before it is transferred and then deemed to have been reinjected. There may be an opportunity in another proceeding to inform the Board on this matter. Even though Union takes the position that diversions cannot occur within storage, and that diversion does not mean a title transfer, a customer wishing to challenge the rights which it thinks it has would find it more difficult to do so if the provision were to be removed. Although the Board supports any efforts on Unions part to clarify the meaning of rate schedules and their provisions, the Board finds that this particular controversial wording should not be removed from the T1 or T3 rate schedules at this time.

### **6.5.2 Rate C1, Storage and Cross Franchise Transportation**

**494** 6.98 The C1 rate for "Storage and Cross Franchise Transportation" services applies to a shipper which enters into a contract with Union for delivery of gas by the shipper to Union at one of Union's listed delivery points for redelivery by Union to the shipper at another of Union's delivery points or to storage.

**495** 6.99 Union proposed to increase the maximum rates for C1 storage and short-term firm transportation services, arguing that the existing maximums do not ensure that Union can capture the full market value of the services provided to ex-franchise customers under this rate schedule.



**496** 6.100 Union submitted that in-franchise customers would benefit under the proposal due to the Board approved sharing (75% ratepayer, 25% shareholder) of the deferred S&T transactional service margin that is underpinned by capacity not required to serve in-franchise requirements. Union added that if ex-franchise customers were able to obtain service at below-market rates, these customers could re-sell the services at market rates and thereby capture the differential that would otherwise benefit in-franchise customers.

### *Intervenors' Positions*

**497** 6.101 LPMA, WGSPG, VECC, and CAC supported Union's C1 proposal.

**498** 6.102 IGUA argued that the CRP was not the appropriate forum to examine the competitiveness of the storage services provided by Union, recommending instead that such a review should be undertaken either in a generic proceeding or in a proceeding initiated by Union to rebase its rates according to a cost of service methodology. IGUA submitted that "... the Board ought to be reluctant to approve Union's proposal.

**499** 6.103 Kitchener opposed Union's proposal on the grounds that the proposal was inconsistent with s.2 of the Ontario Energy Board Act, 1998 in that it was anti-competitive. Kitchener submitted that if Union were able to extract the full premium on C1 services, there would be no incentive for others to transact in these services, thereby stifling the development of a competitive secondary market for these services. Kitchener stated that "[i]f Union is the only provider of services in this area, there is no transactional liquidity and the ability of customers to manage their delivery requirements is impeded."

**500** 6.104 Schools noted that C1 service was available to in-franchise customers as well as ex-franchise customers. Schools argued that in-franchise customers should be able to obtain C1 service at cost-based rates as such customers may have no alternatives to C1 service.

**501** 6.105 Schools added that if EGDI required C1 services, Union's proposal would result in higher costs for EGDI and therefore higher rates for EGDI's customers.

**502** 6.106 Schools urged the Board to deny the proposal suggesting a stakeholder process to review C1 rates in conjunction with Union's storage filing and EGDI's proposed "Storeco Submission."

**503** 6.107 CEED submitted that the Board had never found that the Ontario storage market was competitive, remarking that the Board stated in its RP-1999-0017 Decision that it was unable, on the evidence before it, "... to determine whether storage service can evolve to become workably competitive."

**504** 6.108 CEED noted that in EBRO 494-03, the Board approved the parties to, the term, and the space that was the subject of storage contracts before the Board; the Board also found that parties

had procured storage services at cost-based rates and subsequently "flipped" the storage at a higher rate to third parties, thereby appropriating the rent that would otherwise accrue to Union and its ratepayers.

**505** 6.109 CEED added that Union's reply argument in EBRO 494-03, in support of capturing the rent in the rate, stated that "... the proper way of dealing with the facts, never mind the public interests, the facts, is to capture the value of the storage in the rate so that it can be returned to users of Union's system." CEED argued that this solution was appropriate at the time since the objective was not to facilitate competition.

**506** 6.110 CEED noted the evidence of Ms. Chown in EBRO 494-03 to support its contention that Union should not be able to use its position as system operator to preclude competition.

**507** 6.111 CEED urged the Board to deny Union's request to "deregulate the rates for storage services" noting that Union had not requested that the Board exercise its power to refrain under Section 29(1) of the Act.

**508** 6.112 CEED concluded that "... the Board should focus on avoiding the accumulation of rents by ensuring that the market is, in fact, made more competitive. ... [I]n a competitive market, transactional services are appropriately provided at market rates ..."

### *Union's Reply*

**509** 6.113 Union agreed with IGUA that this proceeding was not the appropriate place to debate the competitiveness of the storage market.

**510** 6.114 Union reiterated that its proposal was intended to maximize the margin returned to Union and its customers: Union stated that it would be inappropriate for another party to capture the margin.

**511** 6.115 In response to Schools' concerns, Union noted that alternatives to C1 service exist. Furthermore, Union noted that in-franchise customers receive an allocation of cost-based storage to meet their requirements as established by a Board-approved methodology.

**512** 6.116 Union stated that C1 service customers are "generally brokers, marketers and LDCs in other jurisdictions." Union noted that EGDI, a C1 and M12 customer of Union, had raised no concerns with respect to Union's proposed C1 rate schedule changes.

**513** 6.117 Union disputed Kitchener's contention that its proposal would stymie development of a competitive secondary market, arguing that the proposal would only reduce "artificial arbitrage opportunities that would exist if the prices Union could charge were constrained and others were given the opportunity to mark them up ...". Union submitted that "legitimate" transactions would not be eliminated. Union concluded that "[i]n a competitive market, pricing constraints are not placed

on some service providers by a regulator so that others can profit by reselling these utility services."

### ***Board Findings***

**514** 6.118 The Board believes that it is appropriate for Union to attempt to maximize the value of existing utility assets that are being used to provide services beyond in-franchise requirements as to do otherwise involves unnecessarily foregoing a benefit.

**515** 6.119 The Board notes that the asset value may be maximized regardless of whether Union or another party receives the full market value: under Union's proposal, any additional premium realized would be shared 75%:25% between ratepayers and the shareholder; under the proposal of some other parties, some of the premium would be captured by any party able to obtain such services at a price below market value.

**516** 6.120 The issue therefore remains as to who should benefit from the premium between the market value and the cost of services provided.

**517** 6.121 In this regard, the Board notes that Union, when asked in EBRO 486-02 why in-franchise customers should receive the difference between market value and the cost of tendered storage, gave the following rationale: that the in-franchise customers "had substantiated the development of space"; that "the underlying cost of that storage and the development costs to create the deliverability are in-franchise cost of service"; and that "the in-franchised ultimately bear a greater risk of the space and the cost. They bore the cost for the initial undertaking of developing the space, and should that space not be utilized in the future, they would probably have those costs visited upon them. The M12s can terminate the contracts and walk away; the in-franchise cannot."

**518** 6.122 In the Board's view, these considerations, expressed by Union in a prior proceeding, are still relevant to this issue. Further, notwithstanding the concerns of some parties that Union's proposal will inhibit the development of the secondary storage market, the Board believes that it would be inappropriate, in an attempt to foster development of the secondary market, to require a regulated utility to provide such transactional services -- excess to in-franchise requirements and underpinned by utility assets substantiated by in-franchise customers -- to other parties at a discount to market value: such an approach merely transfers the net benefits to a third party who simply has to mark up the service and flip it to realize a gain.

**519** 6.123 The Board therefore accepts Union's proposal to increase the maximum rates on the C1 schedule at this time.

**520** 6.124 While the Board believes that an extensive review of the state of competitiveness of the market for storage services in Ontario would be of significant value in any determination to refrain under Section 29(1) of the Act, the Board accepts the view that the current proceeding would not have been the appropriate forum in which to engage in such a debate.

### **6.5.3 M13, M16, C1 Firm Transportation - Customer Supplied Fuel**

**521** 6.125 Union has proposed that it have the option to request M13, M16, and C1 firm transportation service customers to provide their own fuel. This issue was not resolved in the CPR Conference and was questioned during the proceeding.

**522** 6.126 In argument Union stated it was seeking changes to the rate schedules to allow for customer-supplied fuel. Union's witness, Mr Packer, said, "Although the pre-filed evidence indicates that the provision of customer-supplied fuel was composed to be at Union's option, the actual wording changes sought to the rate order would not provide Union with the authority to require a customer to supply fuel if served under those rate classes." Union submitted that it expects that customers served under these rate schedules will want to supply their own fuel, but that if the customer wanted Union to continue to provide its own transmission fuel, Union would continue to do so.

**523** 6.127 IGUA stated that, provided the rate schedule change that Union proposes does not allow Union to impose an obligation on a customer to supply its own fuel, then Union's proposal is acceptable to IGUA.

**524** 6.128 LPMA and WGSPG supported the addition of this option for the customer to supply its own compressor fuel. They also submitted that, while the compressor fuel volumes for these rate classes is likely to be small, in the next customer review process Union should report on the reduction in the volume of compressor fuel required by Union as a result of this change.

**525** 6.129 In response to the argument of LPMA and others, Union stated that the additional cost of reporting on the amount of compressor fuel provided by M13, M16 and C1 customers rather than Union, would not be commensurate with any value that could be obtained from reviewing this information. Furthermore, Union sees little value in the possible results since, in their view, the provision of more customer-supplied fuel would not have any impact on the calculation of pass-through adjustments or rates.

**526** 6.130 The Board sees no objection to permitting union an option to request customers to provide their own fuel. With respect to the request of some intervenors to report on what volume of gas is transported for which the customer provides its own fuel, the Board does not know what value stakeholders would find in that information; nor does it understand why it would be costly to Union to provide such information. Stakeholders, if they so wish this information, may renew their request for it through an interrogatory process in a subsequent CRP.

## **7. IMPLEMENTATION AND OTHER MATTERS**

### **7.1 NEW RATE SCHEDULES, IMPLEMENTATION OF NEW RATES, AND RELATED ORDERS**

**527** 7.1 In its decision in RP-2000-0078 issued July 31, 2002, the Board directed Union to implement changes to rate schedules resulting from that decision at the same time as it implements rate schedule changes arising from the Board's decision in the RP-2001-0029 proceeding.

**528** 7.2 Furthermore, as noted in the decision in RP-2000-0078, Union is to revise its rate schedules to address the Board's concerns in respect of clarity and ease of understanding as discussed in the transcript of the hearing on February 26, 2002 (ERF reference: 128R1-2:488).

**529** 7.3 In respect of all changes affecting rate schedules arising out of RP-2000-0078 and RP-2001-0029, the Board requires that Union provide a draft rate order along with updated rate schedules supported by detailed working papers explaining the changes and, wherever applicable, showing relevant calculations supporting the changes. Similarly, the Board requires Union to show detailed schedules indicating deferral account balances which are to be disposed of and the manner of their disposition in accordance with this decision.

**530** 7.4 The proposed schedules and working papers should be served on the Board and all intervenors as soon as practical, but no later than 28 days from the date of this decision. As a courtesy and to make expedient use of time for review, Union should notify intervenors and the Board as soon as possible as to the anticipated date for such service. Intervenors and Board staff will have 7 days to file questions and comments with Union and with the Board. Union will have 3 days to respond. The Board will then make its determinations and issue an appropriate order.

## **7.2 ADMINISTRATIVE MATTERS**

**531** 7.5 Procedural Order No. 1 in RP-2001-0029 made the usual request:

"The Board requests that all parties make every effort to include a copy of their filings on disk, in WordPerfect format, along with the hard copies which are filed."

**532** 7.6 Upon request from Board staff following the hearing, Union provided electronic copies of the CRP Conference Report and of its reply argument. Union's pre-filed evidence and supplementary evidentiary submissions were not filed electronically.

**533** 7.7 The Board has appreciated being able to electronically search intervenor evidence and other submission in this proceeding. It would have assisted the Board to have Union's evidence in electronic form too. In the past, in addition to submissions in WordPerfect, the Board has been assisted by filings received in Microsoft Word or Excel or other commonly used software formats. The Board would even be assisted by receiving submissions in ASCII DOS text format, if one of the above stated formats is not available.

**534** 7.8 ERF procedures, when made mandatory by the Board, will satisfy the needs of the Board and other interested parties for documents in electronic form. For a number of years, however, the

Board has requested that documents be provided in electronic form on a best efforts basis. In the Board's view such electronic filings should be "required" in Union Gas proceedings until supplanted by new ERF practices. Parties with no electronic word processing capabilities will, on so stating, be given relief from this requirement.

### **7.3 COST AWARDS**

**535** 7.9 The Board will issue its decision on cost awards in due course.

DATED at Toronto, September 20, 2002

Malcolm Jackson  
Presiding Member

George A. Dominy  
Member

Paul B. Sommerville  
Member

\* \* \* \* \*

[Editor's note: Appendix A was not attached to the copy received from the Board and is therefore not included in the Decision.]

\* \* \* \* \*

## APPENDIX B

**Abbreviations used in RP-2001-0029:**

Act	the <i>Ontario Energy Board Act, 1998</i> , S.O. 1998, c. 15, Sched. B
ADR	alternative dispute resolution
Alliance	Alliance Pipelines
Alliance Vector	the Alliance and Vector pipelines
Application	Union application dated July 30, 2001
Barnett	P. Barnett Construction Inc.
Bcf/d	Billion cubic feet per day
Board	Ontario Energy Board
CAC	Consumers' Association of Canada
CEED	Coalition for Efficient Energy Distribution
CME	Canadian Manufacturers & Exporters Inc.
Conference	the settlement conference in RP-2001-0029
Conference Report	the report of the Conference entitled "RP-2001-0029 Union Gas Settlement Agreement" dated March 22, 2002
CRP	customer review process of Union's PBR, initially described in RP-1999-0017
DCC	the Delivery Commitment Credit offered to Union's direct purchase customers which obligate to deliver to Union at a constant daily rate
DCQ	Daily Contract Quantity
Direct Energy	Direct Energy Marketing Limited
DSM	demand side management
EBO	Energy Board Order
EBRO	Energy Board Rate Order
EGDI	Enbridge Gas Distribution Inc., formerly The Consumers' Gas Company Ltd.
ERF	electronic regulatory filing
ESM	earnings sharing mechanism, initially described in RP-1999-0017
FERC	the Federal Energy Regulatory Commission, USA
GDPPI	the Canadian Chain Gross Domestic Product Price Index
GEC	Green Energy Coalition
GJ/d	Gigajoules per day
HONI	Hydro One Networks Inc.
HVAC Coalition	The Heating, Ventilation, Air Conditioning Contractors Coalition Inc.
I	inflation factor based on GDPPI
IGUA	Industrial Gas Users Association

IUC	incremental unbundling costs
Kitchener	The Corporation of the City of Kitchener
LPMA	London Property Management Association
LRAM	Lost Revenue Adjustment Mechanism
MMcf/d	million cubic feet per day
NAC	normalized average consumption
NEB	the National Energy Board, Canada
NRRI	the National Regulatory Research Institute, USA
OAPPA	Ontario Association of Physical Plant Administrators
Oxford	Oxford Automotive
PBR	performance based regulation, initially described in RP-1999-0017
PCI	price cap index
QRAM	Quarterly Rate Adjustment Mechanism as approved by the Board
ROE	return on equity
RP-1999-0017	proceeding to hear the Application dated March 5, 1999; see decision dated July 21,2001
RP-2000-0078	a proceeding to enable the unbundling of services and rates for small volume customers on the Union system
RP-2001-0029	proceeding to hear the Application dated July 30, 2001, this application
Settlement Agreement	same as Conference Report in RP-2001-0017
S&T	Storage and Transportation
SQI	service quality indicators
TCG	The Convergence Group
TCPL	TransCanada PipeLines Limited
Tobacco Growers	Ontario Flue-Cured Tobacco Growers Marketing Board
Union	Union Gas Limited
VECC	Vulnerable Energy Consumers' Coalition
Vector	Vector Pipelines
WACOG	weighted average cost of gas
WEI	Westcoast Energy Inc.
WGPSG	Wholesale Gas Purchasers Service Group
X	productivity factor