



ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION

**Union Gas Limited
Community Expansion Proceeding
EB-2015-0179**

June 21, 2017

1. Background

In the Ontario Government's 2013 Long-Term Energy Plan, the Government stated that it would look at opportunities to expand natural gas service within the Province to areas that are not currently served. On February 17, 2015, the Ontario Minister of Energy, in a letter to the Chair of the Ontario Energy Board (OEB), encouraged the OEB to examine opportunities to facilitate access to natural gas services to more communities. On February 18, 2015, the OEB issued a letter stating that it would hear requests for regulatory flexibility or appropriate exemptions in the context of an application made for approvals pertaining to expansion projects. The OEB invited parties with the appropriate technical and financial expertise to propose, within their application, options to facilitate community expansion.

In response to the letter, Union Gas Limited (Union) filed an application¹ in July 2015 with the OEB seeking approval to provide natural gas service to certain communities that do not have access to natural gas. In that application, Union proposed new approaches to recover revenues for the expansion projects, including a surcharge from new customers and contributions from existing customers.

Under its original proposal, Union anticipated that it could complete approximately 29 projects to provide natural gas service to 18,000 homes and businesses in 34 communities, at an estimated cost of \$135 million.

Based on the submissions of the parties in the Union proceeding, the OEB, through a letter dated January 20, 2016, informed all parties that it intended to proceed with a generic hearing on its own motion as the issues raised by all parties were common to all gas distributors and new entrants seeking to provide gas distribution services in communities that do not have access to natural gas. The OEB noted that a generic proceeding would allow it to establish a common framework and provide guidance to all entities that wish to provide gas distribution services in communities across Ontario. Accordingly, the OEB established a generic hearing on its own motion to deal with these common issues².

The OEB decided to put Union's application on hold until the completion of the generic hearing³. On November 17, 2016, the OEB issued its Decision on the Generic Community Expansion Proceeding (Generic Decision). The Generic Decision determined that many new community expansion customers would realize significant

¹ EB-2015--179

² Eb-2016-0004

³ Letter of the OEB dated January 20, 2016

savings from converting to natural gas within the life expectancy of the infrastructure. The savings from converting to natural gas would exceed the cost of expansion and therefore, subsidization from existing customers is not an appropriate mechanism to fund expansion. The OEB further noted that “postage stamp” rates of existing utilities was the primary hurdle and implementation of stand-alone rates for the communities would ensure that the costs to expand are recovered from the communities that benefit from the expansion. The OEB also indicated that an incumbent utility with existing rates could propose to collect a surcharge over and above existing rates to make up for the shortfall in revenues to cover the cost of the expansion.

In Procedural Order No. 4 issued on November 17, 2016, the OEB determined that it would resume Union’s application that had been put in abeyance and directed Union to advise the OEB on how Union proposed to proceed with its application in light of the Generic Decision. In a letter dated December 22, 2016, Union advised the OEB that it intended to file a revised application by the end of March 2017.

Union filed its updated evidence on March 31, 2017. Union’s updated application proposed four expansion projects to serve the following communities in : 1. Kettle and Stony Point First Nation and Lambton Shores (on the southern shores of Lake Huron approximately 35 kilometres east of Sarina); 2. Milverton, Rostock and Warburg (located in south-western Ontario, in the County of Perth, 43 kilometres west of Kitchener-Waterloo); 3. Prince Township (located to the west and north of the City of Sault Ste. Marie, near the Sault Ste. Marie airport); and 4. the Delaware Nation of Moraviantown First Nation (along the Thames River near Thamesville, Ontario).

Union’s application proposed a surcharge to existing rates for a defined period of time not to exceed 40 years towards recovery of the cost of the projects. Of the four projects, Union is seeking specific leave to construct approval to provide gas service to the three communities stated above with the exception of the Delaware Nation of Moraviantown. Union is planning to provide service to the Delaware Nation of Moraviantown First Nation subject to receipt of the necessary Aid-to-Construction and approval of the surcharge. The applications have been made under section 36 and section 90 of the *Ontario Energy Board Act, 1998*.

Union holds a Certificate of Public Convenience and Necessity for each of the project areas, existing Franchise Agreements for Lambton Shores, Milverton, and Prince Township, and is in the process of obtaining necessary permits under the *Indian Act* for Kettle and Stony Point First Nation and the Delaware Nation of Moraviantown First Nation.

In Procedural Order No. 7 issued on April 26, 2017, the OEB determined a list of intervenors in the proceeding and scheduled a round of interrogatories and a Settlement Conference.

On May 18, 2017, the Batchewana First Nation of Ojibways requested intervenor status and cost eligibility. Batchewana First Nation claimed aboriginal and treaty rights in the areas that will be served by the proposed Prince Township expansion. The Batchewana First Nation noted that its rights and interests trigger the Crown's Duty to Consult and it was of the opinion that consultation thus far has been deficient.

In response, Union filed a letter dated May 24, 2017 indicating that it did not object to the intervention request of the Batchewana First Nation. However, it submitted that the intervention request should only apply to the section 90 leave to construct proposal to serve Prince Township and should not impact the remaining three proposed projects or the section 36 rate surcharge proposal for each project.

In Procedural Order No. 8 issued on May 25, 2017, the OEB approved the intervention request of the Batchewana First Nation and its request for cost eligibility under the OEB's *Practice Direction on Cost Awards*. The OEB also determined that the Batchewana First Nation's interest would be limited to Union's leave to construct application to serve Prince Township, and that it did not impact the other proposed projects or the section 36 rate surcharge proposal of the proposed projects. The OEB ordered Union and the Batchewana First Nation to provide an update on the consultations undertaken with respect to the Prince Township leave to construct by June 26, 2017.

A settlement conference was held on May 29, 2017, to give an opportunity to the parties to reach a settlement on the issues. However, the parties were unable to reach a settlement and the OEB, through Procedural Order No. 9, ordered a written process for final submissions. The OEB excluded the leave to construct application to service Prince Township from submissions noting that it would issue further procedural direction if the Batchewana First Nation and Union failed to reach an agreement.

The submissions below reflect observations and concerns of OEB staff on the evidence and arguments of Union with respect to an application to provide gas distribution services in the four specific communities.

2. Union Proposal and Staff Submission

Based on the Generic Decision, Union made certain revisions to its original proposal in order to meet the OEB's requirement that there should be no subsidization from existing customers for new community expansions. Union is also no longer proposing a capital pass through treatment for the projects and is not seeking an associated deferral account to capture the difference between actual and forecast amounts.

System Expansion Surcharge

Union has proposed a volumetric-based system expansion surcharge for a defined period of time, not exceeding 40 years, as a means to recover the capital and ongoing OM&A costs of the project from expansion customers. The surcharge is required because the projects are not economic – and would require a subsidy from existing customers at Union's existing rates. Union has proposed a surcharge of \$0.23/m³ as it reflects a typical residential customer achieving a payback period of less than 4 years on the cost of equipment conversion or replacement from the savings of converting to natural gas⁴.

Under Union's proposal the System Expansion Surcharge (SES) would be applied to all general service customers and not to contract rate classes. If a contract rate customer requires service in the new communities, Union has indicated that the Profitability Index (PI⁵) for that customer's connection will need to be a minimum of 1.0. A contribution in aid of capital could be required for the connection to achieve a PI of 1.0.

Union has proposed a consistent SES across the four communities, but the duration of the surcharge reflects the economics of the project. The SES, along with existing rates, is designed to recover the capital and OM&A costs of the project and meet a minimum PI of 1.0. The surcharge will remain constant for the duration of the term and Union has submitted that this approach meets the OEB's minimum rate stability period of 10 years as noted in the Community Expansion Decision⁶. The surcharge will appear as a separate line item on customer bills labelled "*System Expansion Surcharge*". Although the SES will remain constant during the rate stability period and beyond, existing (base) rates may change during the rate stability period based on the rate plan approved by the OEB which could include cost of service rate adjustment, Incentive Rate Mechanism adjustment and Z-factor adjustments.

⁴ Exhibit A, Tab 1, Page 19, Updated Evidence, December 14, 2015

⁵ A PI of 1.0 implies that the projected revenues over a certain number of years on a Net Present Value (NPV) basis are equal to the project costs.

⁶ EB-2016-0004 Decision with Reasons, p.20

The SES rate and the duration for each community are presented below:

Project	SES Rate	SES Expiry Date
Kettle and Stony Point First Nation and Lambton Shores	\$0.23 / m ³	December 31, 2029
Milverton, Rostock and Wartburg	\$0.23 / m ³	December 31, 2032
Delaware Nation of Moraviantown First Nation	\$0.23 / m ³	December 31, 2057
Prince Township	\$0.23 / m ³	December 31, 2039

In its Argument-in-Chief, Union submitted that the proposed term of the SES would not be extended by Union but could be reduced on receipt of incremental funding by municipalities or the government. To the extent a municipality, First Nation or government makes an upfront contribution, Union has proposed to treat this as an Aid-to-Construct to meet the minimum PI of 1.0 and any residual funding would be used to reduce the SES term. Any financial support to a project in the form of an annual payment for an agreed upon term would be treated as an offset to the annual revenue requirement.

Staff Submission

OEB staff support the quantum and duration of the SES charge in the case of these particular community expansion applications, as well as Union's proposed treatment of any incremental funding by other parties, including the government. OEB staff submits that in cases where there is no competition to provide gas distribution services to a new community, a surcharge to existing rates is a cost-effective, potentially subsidy-free option to recover project costs.

In the current application, there is no competing proponent that has expressed a desire to serve the communities. A surcharge has the benefit of being simple to implement for existing utilities by avoiding a requirement to develop stand-alone rates for every new community that the utility intends to provide service to. Existing utilities like Union and Enbridge have multiple rate schedules for their existing customers and they are not specific to municipalities: rather, they are regional or based on serving a specific class of customers, for example, residential, commercial, industrial or contract.

If utilities are required to develop individual rate schedules for every new community, it may be administratively burdensome and could lead to additional costs for customers. OEB staff therefore submits that in certain cases, a surcharge is a viable and cost-effective option that should be considered in community expansions that do not involve competition. In cases where there is competition amongst proponents for providing

service to a new community, the OEB's evaluation criteria could be different so as to ensure that the rates of various proposals can be readily compared.

Forecast Risk

In the discussion of the SES, Union has suggested that its proposal meets the OEB's requirement of a 10-year rate stability period. Union has also proposed that it would bear the risk of fewer customers than forecasted connecting to the system for the duration of the 10 year customer forecast period. For ratemaking purposes, Union's forecasted number of customers for the expansion communities would be the OEB-approved forecasted attachment level in this application. The same approach would be followed for the SES related revenue. Consequently, existing customers of Union would not bear the risk of underachievement of attachment forecast through the initial 10-year period⁷.

For the first 10 years of the project, Union proposes to include the following in its forecast for ratemaking purposes:

- SES revenue as calculated in the Discounted Cash Flow for each project
- The attachment forecast as provided in the application for each project multiplied by the target normalized average consumption (NAC) to arrive at the volume forecast that will be included in the calculation of base rates for each customer class delivery rates
- Delivery price adjustments (for example related to the NAC deferral mechanisms) would also apply to community expansion customers in the same manner as other general service customers.

Following the end of the 10 year forecast period, Union will use the actual attachments and the actual SES revenue for ratemaking purposes subject to OEB review and approval. In other words, Union will not seek to recover from existing or new community expansion customers any shortfall in revenue requirement for the first 10 years of the project. After the 10 year forecast period, Union proposes to use actual attachments and actual SES revenues to set rates going forward. Since Union proposes to reset base rates based on actual attachments any shortfall in revenue requirement (from forecast) for the years 11 to 40 could be borne by all ratepayers (new and existing). Similarly, any excess revenues as a result of under-forecasting attachments could potentially benefit all ratepayers after year 10 or new community expansion customers with a shorter than proposed duration of SES.

⁷ Response to OEB Staff Interrogatory #3

Union has proposed that it would bring forward any potential revenue requirement shortfalls as compared to the forecast in a future rates application after the 10-year forecast period is over, and it would be up to the OEB to approve or adjust any resulting rate impacts. However, Union is not seeking any approvals at this time relating to any rate adjustments after the 10 year forecast period – all of this would be subject to a review by the OEB.

With respect to capital costs, Union has not proposed to assume any risk for any variance in capital costs, that is, if they are higher than forecast. This is because Union will bring forward its actual capital costs in the next rebasing proceeding when the assets are placed in service. This will most likely be before the end of the 10 year forecast risk period. The OEB will review the prudence of the costs if they exceed the original forecast in a future rates proceeding.

Staff Submission

Union has proposed a ten year forecast risk period. In other words, Union will bear the risk of fewer customers and/or lower volumes than forecasted for the 10 year customer forecast period. Existing customers of Union will not be subsidizing community expansion customers for at least the first 10 years of the project. OEB staff supports the proposal of Union for the first 10 years. Thereafter Union has proposed an adjustment wherein it would reset the historical expansion area customer forecast at actual levels for ratemaking purposes going forward (all of which would be subject to OEB approval at that time). The important point here is that Union does not seek to recover any revenue shortfalls based on actual attachments and volumes for the first 10 years of the project. The proposal to use actual attachments in setting rates is only after year 10 for rates going forward. There is no proposal to retroactively allow Union to recover lost revenues as a result of lower attachments for the first 10 years of the project.

OEB staff does not have any specific concern with Union's proposal to reset the revenue requirement going forward after year 10 based on actual attachments and bring the issue before the OEB for adjudication. The OEB's Generic Decision determined that existing customers should not subsidize expansion customers. If Union is seeking some type of variance from that principle presumably it will have to justify that in a hearing before the OEB after the 10 year period.

Further, OEB staff submits that any request by Union for recovering revenue requirement shortfalls after the end of the initial 10-year period, must be supported by information on forecast and actual attachments, volumes, Normalized Average Consumption calculations and resulting revenue shortfalls. Union must also provide a

revised discounted cash flow analysis that uses actual attachments as part of any variance that it intends to seek after the 10-year forecast period. This will allow the OEB to understand the changes in PI after completion of the 10 year forecast risk period and consider options to address potential shortfalls, including the possibility of increasing the SES charge or duration. OEB staff further submits that Union should provide the information proactively in a future rates application in a separate section and must not rely on the collective memory of the intervenor groups or OEB staff to retrieve the information from Union through the discovery process.

With respect to Union's proposed treatment of capital costs, OEB staff submits that Union's approach is similar to other capital projects. Union will bring forward any variance between actual and forecast costs in a future rate application. This would presumably occur before the end of the 10-year forecast period, after the assets are placed into service. If Union is permitted to add any additional amounts (i.e. overspend on capital) to rate base, it would imply that all customers (new and existing) would bear the cost of the additional capital expenditures. The question then is whether existing customers should bear this risk or the risk in capital forecast variance should be borne by Union or new expansion customers.

Union has submitted that it will not be assuming any capital cost forecast risk. This means that existing customers of Union could be responsible for capital expenditures that exceed the initial forecast. OEB staff agrees with the position of Union that the OEB will determine the prudence of any variance in capital expenditures in a future rates application. To the extent that Union has exceeded the capital cost forecast, it would be up to the OEB to determine whether Union, the community expansion customers in question or all customers of Union in the specific rate class should bear the cost of the additional expenditure. Alternatively, the OEB could approve a capital cost deferral account that tracks the variance in capital expenditures related to community expansion projects and review the costs after the expiration of the initial 10-year forecast risk period along with the review of any revenue requirement shortfall that has been explained earlier.

Municipal / First Nation Contribution

In its initial proposal, Union proposed that municipalities or First Nations be required to make a financial contribution to the projects. Based on the determination of the OEB in the Generic Decision that such contributions should be voluntary and not mandatory, Union has modified its proposal to include contributions only if the municipality or First Nation is willing to make a contribution.

To the extent that a municipality or First Nation makes an upfront voluntary financial contribution to a project, Union will treat the contribution as an Aid-to-Construction and accordingly reduce the net capital cost of the project. If a municipality or First Nation agrees to provide ongoing financial support in the form of an annual payment for an agreed upon term, Union will treat the financial support as revenue.

With respect to Union's requested projects in the updated application, the Township of Perth East, which includes the Town of Milverton and surrounding areas, has agreed to make a financial contribution to the project of \$41,000 per year for 10 years. Similarly, the Delaware Nation of Moraviantown will provide ongoing financial contribution of \$5,000 per year for the first 10 years of the project, while Prince Township has agreed to make a financial contribution of \$12,300 per year for the first 10 years of the project.

Staff Submission

OEB Staff has no concerns with voluntary financial contributions from municipalities or Union's proposed treatment of the amounts.

System Advancement Costs

In its original application, Union proposed that costs for upstream distribution system reinforcements be included in the economic assessment for any new attachments or load additions. Union proposed that advancement charges be restricted to situations where material new attachments would result in a need to accelerate future reinforcement to within three years following the year the attachment is put into service. In addition to the above condition, Union proposed that the need for upstream reinforcement advancement charges be restricted to economic assessments where the requirement of a new attachment or load addition is 200 m³/hour or higher.

The project economics of the Milverton expansion proposal includes a system advancement cost of \$126,500. The advancement cost recognizes an estimate of a reinforcement cost of \$1.87 million to occur in year 2020 as compared to the need for the reinforcement in 2022 without demands from the Milverton expansion.

Staff Submission

OEB staff requested that Union provide the calculations in support of an advancement charge of \$126,500. Union provided the calculation in OEB Staff IR number 12 and staff is satisfied that the underlying calculations support the amount. However, Union has not confirmed whether the Milverton project will lead to new attachments or load additions of 200m³/hour or higher, which was one of its criteria in the initial application. Union is requested to confirm this in reply.

Government Funding

On January 30, 2017, the Province of Ontario announced that the previously announced Grant and Loan Program will be replaced with a \$100 million grant program. Union has indicated that it intends to apply for a grant with respect to the Delaware Nation of Moraviantown First Nation project⁸. The Moraviantown project is contingent upon grant funding or some other means of direct Aid-to-Construction to meet a minimum PI of 1.0. The Moraviantown project requires an upfront capital contribution of \$311,467.⁹

Union has submitted that it intends to treat any upfront grants received as an Aid-to-Construction. This would result in an improvement in the PI of each project. Union will accordingly shorten the required SES term for each project as applicable in order to ensure the PI of the projects meet the required threshold of 1.0 and has proposed that it would notify the OEB accordingly without delaying the planned start of construction.

Staff Submission

OEB staff has no specific concerns with respect to Union's proposed treatment of government grants. However, Union has noted that the Moraviantown project is contingent upon grant funding or some other type of upfront contribution. OEB staff urge Union to update the OEB on whether it has applied for a government grant with respect to the Moraviantown project and the current status of the grant application. It is also not known how long Union intends to wait before it will abandon the Moraviantown project due to lack of funding.

Leave to Construct Applications – Section 90 of OEB Act

Union has applied for an order granting leave to construct approval for the natural gas pipelines and ancillary facilities required to serve the communities of Milverton, Rostock and Wartburg (Municipality of Perth East); Prince Township; and the Chippewas of Kettle and Stony Point First Nation and Lambton.

OEB staff has reviewed Union's evidence in the proceeding and has no concerns with the specific leave to construct applications with the exception of Union accepting Staff's proposed standard conditions of approval, which are attached as Appendix A. If Union does not agree to any of the draft conditions of approval, it is requested to identify the specific conditions that Union disagrees with and provide reasons including proposed changes. The standard conditions are a draft version subject to additions or changes.

⁸ Response to CPA Interrogatory #5

⁹ Pre-filed Evidence, Exhibit A, Tab 2, Section C, Page 3, Para. 12

OEB staff understands that the OEB through Procedural Order No. 9 has excluded Prince Township from final arguments pending the outcome of the discussions between Union and the Batchewana First Nation. Should Union and the Batchewana First Nation come to a mutual agreement on the Prince Township leave to construct application, OEB staff submits that it has no concerns with the Prince Township leave to construct application in its current form with the exception of Union agreeing to the standard conditions of approval.

– All of which is respectfully submitted –

Appendix A
To OEB Staff Submission
EB-2015-0179
June 21, 2017

Draft
Leave to Construct Conditions of Approval
Application under Sections 90 of the OEB Act
Union Gas Limited
EB-2015-0179

- 1 Union Gas Limited (Union) shall construct the facilities and restore the land in accordance with the Board's Decision and Order in EB-201x-0xxx and these Conditions of Approval.

- 2 (a) Authorization for leave to construct shall terminate 12 months after the decision is issued, unless construction has commenced prior to that date.

(b) Union shall give the OEB notice in writing:
 - i. of the commencement of construction, at least ten days prior to the date construction commences;
 - ii. of the planned in-service date, at least ten days prior to the date the facilities go into service;
 - iii. of the date on which construction was completed, no later than 10 days following the completion of construction; and
 - iv. of the in-service date, no later than 10 days after the facilities go into service.

- 3 Union shall implement all the recommendations of the Environmental Protection Report filed in the proceeding.

- 4 Union shall advise the OEB of any proposed change to OEB-approved construction or restoration procedures. Except in an emergency, Union shall not make any such change without prior notice to and written approval of the OEB. In the event of an emergency, the OEB shall be informed immediately after the fact.
- 5 Union shall file, in the proceeding where the actual capital costs of the project are proposed to be included in rate base, a Post Construction Financial Report, which shall indicate the actual capital costs of the project and shall provide an explanation for any significant variances from the cost estimates filed in this proceeding.
- 6 Both during and after construction, Union shall monitor the impacts of construction, and shall file with the OEB one paper copy and one electronic (searchable PDF) version of each of the following reports:
 - a) a post construction report, within three months of the in-service date, which shall:
 - i. provide a certification, by a senior executive of the company, of Union's adherence to Condition 1;
 - ii. describe any impacts and outstanding concerns identified during construction;
 - iii. describe the actions taken or planned to be taken to prevent or mitigate any identified impacts of construction;
 - iv. include a log of all complaints received by Union, including the date/time the complaint was received, a description of the complaint, any actions taken to address the complaint, the rationale for taking such actions; and
 - v. provide a certification, by a senior executive of the company, that the company has obtained all other approvals, permits, licences, and certificates required

to construct, operate and maintain the proposed project.

- b) a final monitoring report, no later than fifteen months after the in-service date, or, where the deadline falls between December 1 and May 31, the following June 1, which shall:
- i. provide a certification, by a senior executive of the company, of Union's adherence to Condition 3;
 - ii. describe the condition of any rehabilitated land;
 - iii. describe the effectiveness of any actions taken to prevent or mitigate any identified impacts of construction;
 - iv. include the results of analyses and monitoring programs and any recommendations arising therefrom; and
 - v. include a log of all complaints received by Union, including the date/time the complaint was received, a description of the complaint, any actions taken to address the complaint, the rationale for taking such actions.