

June 21, 2017

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
P.O. Box 2319
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

**RE: EB-2015-0179 – Final Argument of the Consumers Council of Canada – Union Gas Limited –
Community Expansion Projects**

Please find, attached, the Final Argument of the Consumers Council of Canada in the above-referenced proceeding.

Yours truly,

Julie E. Girvan

Julie E. Girvan

CC:

All Parties
Michael Buonaguro, Counsel

FINAL ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA

EB-2015-0179

APPLICATION BY UNION GAS LIMITED FOR COMMUNITY EXPANSION

INTRODUCTION

These are the submissions of the Consumers Council of Canada (the “Council”) with respect to Union Gas Limited’s (“Union”) application to the Ontario Energy Board (“OEB” or “Board”) for:

- a) An order granting leave to construct approval for the natural gas pipelines and ancillary facilities required to serve the following communities (the “Community Expansion Projects”):
 - i) Kettle and Stony Point First Nation and Lambton Shores,
 - ii) Milverton, Rostock and Wartburg, and
 - iii) Delaware Nation of Moraviantown First Nation; and
- b) An order approving a project specific system expansion surcharge (“SES”) rate for the Community Expansion Projects.

Further to the Board’s direction these submissions do not directly address Union’s requests with respect to the proposed Prince Township Project.

The Council’s submissions are focused on the issue of the appropriate allocation of risks associated with Community Expansion Projects as between existing customers, new customers, and Union.

Union’s application falls within the scope of the Board’s decision in EB-2016-0004, released November 17, 2016, (the “Generic Decision”) which establishes a framework for the approval of expansion projects such as the ones proposed by Union.

The Generic Decision asserts that the existing E.B.O. Guidelines will continue to apply to “contiguous expansions of the existing system”:

Contiguous expansion of the existing system with development on the edge of serviced areas would continue to be managed under the E.B.O. 188 framework. Demarcation criterion will be needed to separate those

projects that would appropriately be dealt with in that manner rather than applying for new rates.¹

Union does not assert that the Community Expansion Projects in this application would or could qualify for treatment under the existing E.B.O. 188 framework. Accordingly, the Council submits, it is not necessary to consider the appropriate demarcation criteria that should be used in order to determine whether any of the projects qualify for treatment under the existing E.B.O. 188 framework.

For projects that cannot be accommodated by or do not qualify for management under the existing E.B.O. 188 Guidelines, the Board contemplates the use of stand-alone rates:

The OEB agrees with the submissions of South Bruce and CCC that support the establishment of stand-alone rates. The OEB considers it appropriate to allow proponents to apply for rates that are geared towards the costs of the individual projects, or groups of projects where they have similar cost drivers. There is no need to modify the parameters or depart from the principles embodied in E.B.O. 188 to facilitate expansion projects.²

However, Union has not proposed or provided a calculation of project specific stand-alone rates to be applied to the Community Expansion Projects, instead relying on the Board's further finding that:

An incumbent utility with existing rates may still propose to collect a surcharge over and above those rates to make up for the shortfall in revenues to cover the cost of the expansion. This form of funding does not depart from the mechanics or principles embodied in the E.B.O. 188 assessment.³

In the Council's view Union's proposal to collect a surcharge over and above existing rates, while permitted by the Generic Decision, raises the issue as to whether Union's proposal properly allocates the risks associated with the projects amongst the relevant stakeholders as contemplated in the Generic Decision.

As part of the Generic Decision the Board noted that:

The OEB expects to refine the mechanisms and features of the framework described here through the adjudication of the initial

¹ EB-2016-0004, Decision released November 16, 2016, page 19.

² EB-2016-0004, Decision released November 16, 2016, page 18.

³ EB-2016-0004, Decision released November 16, 2016, page 21.

applications and will seek submissions from applicants and affected parties on implementation matters within those applications.⁴

In the Council's view the proper allocation of the risks associated with Union's proposal is precisely the type of implementation matter that was not directly addressed by the Generic Decision such that the Board will have to refine the proposed mechanism as part of the adjudication of this application.

ALLOCATION OF RISKS WHEN STAND-ALONE RATES ARE PROPOSED

When projects proceed by way of stand-alone rates, doing so not only provides for competition amongst parties wishing to provide natural gas service to un-served areas, it also completely shields existing ratepayers from the risks associated with such projects. As noted in the Decision:

With the ability to propose new rates there is no need to test the profitability of projects against existing rates. Proposals will need to be self-financing and therefore there will be no risk to existing ratepayers.⁵

Through stand-alone rates, new ratepayers are required to fund the expansion costs, with the distributor taking on the risk of under-recovery through the imposition of a "rate stability period".

During the rate stability period the distributor takes on the risk associated with the forecast costs and revenues that it used to set the stand-alone rates for the project.⁶ Only after that period are new customers exposed to the risk associated with the original forecasts, although subject to the requirement that the distributor apply for adjustments to stand-alone rates after the expiry of the rate stability period.⁷

ALLOCATION OF RISKS UNDER UNION'S PROPOSAL

Having proposed a surcharge on top of existing rates rather than stand-alone rates, Union's current proposal shifts risk associated with the Community Expansion Projects onto existing customers, risks that existing customers would not bear under a proposal premised on stand-alone rates.

While it is true that under Union's proposal existing ratepayers are largely protected against any revenue shortfall during the proposed rate stability period of 10 years,

⁴ EB-2016-0004, Decision released November 16, 2016, page 21.

⁵ EB-2016-0004, Decision released November 16, 2016, page 19.

⁶ EB-2016-0004, Decision released November 16, 2016, page 20.

⁷ EB-2016-0004, Decision released November 16, 2016, page 21.

Union's proposal is that any revenue shortfall in years 11 and beyond is passed onto existing ratepayers, subject only to Board approval of new rates.⁸

With respect to the risk that the capital costs deviate materially from what is contemplated by the forecast costs, Union's proposal is that existing ratepayers bear 100% of the risk of such a deviation as soon as they occur, subject only to the natural delay between the in-service date of the project and the inclusion of the capital costs of that project in rates.

Under Union's proposal new customers do not directly bear any risks with respect to the expansion once the level and term of the proposed SES is approved. Instead, new customers are subject to the risks associated with Union's existing rates, in addition to the obligation to pay an SES charge for a number of years without regard for the actual costs and revenues associated with the expansion.

In the Council's view Union's proposal should be adjusted in order to provide for an allocation of risks that more closely matches the allocation of risks that are inherent in a proposal wherein stand-alone rates are established.

APPROPRIATE ALLOCATION OF RISKS-EXISTING CUSTOMERS

The Council respectfully submits that the Board's finding in the Generic Decision is unambiguous in its determination that existing customers are not to take on the risks associated with Community Expansion Projects.

As already noted, proposals that proceed by way of stand-alone rates do not expose existing ratepayers to any of the risks associated with the proposal; any such risk is shared by the proponent of the proposal (in this case Union) and the new customers that will be connected as a result of the expansion. In the Council's view the protection afforded existing customers by the Generic Decision should not be removed as a result of Union exercising the option to propose a surcharge on top of existing rates rather than calculate stand-alone rates for the proposed expansion.

Accordingly, it is the Council's respectful submission that Union's proposals with respect to the allocation of the risks associated with its Community Expansion require modification. This is required in order to properly reflect the Generic Decision with respect to the protection of existing customers, and to more appropriately allocate the risks of the projects between new customers and Union.

⁸ The Council suggests that existing ratepayers are only "largely" protected against any revenue shortfall from the project because under Union's proposal it only takes on the risk associated with the customer attachment forecast in relation to revenues from existing rates; Union does not take on the risk associated with the rate itself, or the volumetric forecast underpinning the revenue forecast. It is only the risk associated with the revenue from the proposed SES that existing customers are "perfectly" protected against during the proposed rate stability period.

APPROPRIATE ALLOCATION OF RISKS-NEW CUSTOMERS

With respect to the risks that are borne by new customers, the Council respectfully submits that it would be inappropriate to subject new customers to specific risks associated with the project subsequent to the approval of an SES level and term.

In the Council's view once the level and term of the SES is approved by the Board in the leave to construct application, new customers should not be subject to either an increase in the level of the SES or an increase in the term of the SES, as the risk of changes in either or both of those variables could materially affect the decision of a potential new customer to attach to the system. Their decision to attach to the system should be based on a known SES level and term.

The Council notes that the proposals before the Board in this proceeding and, it would seem, the majority of potential community expansion proposals largely entail signing up individual residential customers for gas service, with the added SES related obligation for those individual residential customers being determined by the proponent (in this case Union) based on the proponent's evaluation of the costs and benefits of the proposal and the proponent's forecast of customer attachments to the project. In this context the Council submits that it would be profoundly unfair to market the expansion to individual customers on the basis of an SES related obligation for a set level and duration, but leave open the potential for additional burdens on each individual new customer years into the future based on the inability of the proponent to sufficiently market the expansion. In cases where the distributor's forecasts are materially in error the impacts on individual new residential customers that agree to invest in and convert to natural gas and pay a SES charge for several years could be catastrophic.

By way of example, the project economics for the Milverton proposal are based on an attachment forecast of 739 customers by year 10;⁹ if only 50% of the forecast customers attach as forecast then the residual obligation on those customers that do attach would likely come close to doubling, an obligation that would only be triggered after the Board reassesses the accuracy of the underpinning forecast. In the Council's view subjecting a small subset of new customers to that magnitude of risk, particularly when the manifestation of that risk is entirely caused by third parties those customers have no specific relationship with or influence over would be entirely inappropriate.

It is true that, under a proposal based on stand-alone rates, new customers take on the risks associated with the project after an approved "stability period". However, under stand-alone rates, new customers are protected against the risks associated with changes in existing rates that do not impact on the new service area. That is not the case under Union's proposal, as new customers bear the risks associated with

⁹ Exhibit A Tab 2 Section B Schedule 2.

existing rates as soon as they are connected. In the Council's respectful submission it is inappropriate to expose new customers to the risks associated with existing rates and, in addition, expose those same customers directly to the risks associated with the new project once an approved SES level and term is set.

It is the Council's understanding that Union's proposal is to never increase the level of the approved SES or increase the term of the approved SES once initial approval is provided, such that it is consistent with the Council's position.

The Council is not adverse to a proposal that would provide a utility with the flexibility to reduce an SES below the approved level or term under certain circumstances as appropriate; this possibility is discussed in the next section of this argument in relation to the risks allocated to Union as the distributor.

APPROPRIATE ALLOCATION OF RISKS-UNION

In the Council's view it would be appropriate for Union to bear the full risk associated with their proposed Community Expansion Projects as a result of their reliance on an SES charge rather than a true stand-alone rate.

Union's proposal is to take on the risk with respect to SES revenue for only the first 10 years of the SES term, with existing customers being exposed to the risk of SES revenue shortfall beyond 10 years. The Council submits that existing customers should be entirely protected from SES related risk, and that the appropriate way to extend such protection is to have the distributor bear the risk associated with SES revenue for the duration of the proposed SES term. As noted previously the Council believes it would be unfair to subject new customers to the risk of changing SES levels or terms once approval for the project is granted.

Similarly the Council submits that the distributor should bear the risks associated with the forecast capital costs of the project and with respect to the forecast customer attachments, such that the distributor should be required to impute revenue to offset the revenue requirement associated with any excess capital costs or shortfall in customer attachments until such imputation is no longer required in order for the project to achieve the require PI of 1.0.

Conversely, the Council notes, the distributor should benefit from any cost savings relative to forecast that it can achieve, as well as any excess revenue received if the approved customer attachment forecast is exceeded.

The Council notes that the distributor is at liberty to suggest essentially any level of SES and any term of SES that it sees fit given the circumstances of the proposed project. Accordingly, the Council suggests it may be appropriate for a distributor to suggest a level and/or term of SES that is higher/longer than what is necessary to meet a PI of 1.0 for the project based on its reasonable customer attachment

forecast and forecast of capital costs in order to shift more of the risk associated with the project to new customers.

However, where a distributor seeks to artificially increase the approved level or term of the SES in order to specifically shift risk to new customers, the fact that that is being done should be identified in the application and a mechanism be included to reduce the SES level and/or term in the future in order to protect new customers from over-contributing to the project as a result of the distributor's choice to artificially increase the potential recovery from new customers. For example, a reduction to the SES term may be appropriately determined within a year of the completion of the project if the approved SES term was specifically extended to offset the risk of capital costs in excess of the original forecast.

CONCLUSION

In summary, the Council respectfully submits that in situations such as in this application, where a utility seeks approval for Community Expansion Projects and related surcharges to be applied in conjunction with existing rates rather than establishing stand-alone rates, the Board should only allow the Projects and surcharges to proceed on the basis of an appropriate and explicit allocation of the risks associated with the Projects between the relevant stakeholders. In the Council's view an appropriate allocation of risks is established when:

- a) existing ratepayers are held harmless with respect to the risks associated with the Projects,
- b) new customers are presented with a maximum SES level and term in advance of the Projects, providing a firm maximum obligation to the distributor and protecting them against future project related increases, and
- c) distributors take on the risks associated with the Projects, subject to their ability to protect themselves against some of that risk by requesting longer SES terms and higher SES levels as part of the approval process, with the requirement that such increases or extensions be reduced to the benefit of new customers if the additional revenue is not required to make the subject project economic.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 21st DAY OF JUNE 2017