



EB-2016-0137
EB-2016-0138
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South Bruce Expansion Applications

**Applications to serve the Municipality of Arran-Elderslie,
the Municipality of Kincardine and the Township of
Huron-Kinloss with natural gas distribution services**

DECISION ON PRELIMINARY ISSUES AND PROCEDURAL ORDER NO. 8

August 22, 2017

EPCOR Southern Bruce Gas Inc. (EPCOR) filed applications with the Ontario Energy Board (OEB) on March 24, 2016 under sections 8 and 9 of the *Municipal Franchises Act*, R.S.O. 1990, c. M.55, seeking approval for its franchise agreements with and Certificates of Public Convenience and Necessity for the Municipality of Arran-Elderslie, Municipality of Kincardine and the Township of Huron-Kinloss (“the South Bruce Expansion Applications”). Procedural Order No. 1, which was issued on January 5, 2017, directed other parties interested in serving the areas covered by the South Bruce Expansion Applications to notify the OEB of their interest. Union Gas Limited (Union) filed a letter dated January 19, 2017 notifying the OEB of its interest in serving the areas covered by the South Bruce Expansion Applications.

Through procedural orders, the OEB determined that it would hear the applications to serve the areas in two phases. In the first phase, the OEB would consider submissions on certain preliminary issues, and in the second phase, the OEB would select either EPCOR or Union as the successful proponent.

On June 23, 2017, the OEB issued a Partial Decision and Procedural Order No. 6 (the Partial Decision), which addressed two of the issues on the Preliminary Issues List, and which also required both EPCOR and Union to participate in a joint session with OEB staff on July 13, 2017 to determine the technical parameters of a Common Infrastructure Plan (CIP) for the area covered by the South Bruce Expansion Applications.

On July 20, 2017, OEB staff submitted a progress report (Staff Progress Report) which outlined the CIP parameters discussed in the joint session, areas of agreement and disagreement between proponents, draft permissible rate adjustment criteria and proposal comparison criteria. The proponents requested that the OEB allow for submissions on the areas of disagreement.

On August 2, 2017, pursuant to Procedural Order No. 7, the OEB heard oral submissions from EPCOR and Union regarding each of the areas of disagreement listed in OEB staff's progress report: upstream reinforcements, inflation costs, OM&A costing methodology, treatment of capital costs, other CIP parameters and permissible rate adjustments. The OEB also heard from the proponents on the process for moving forward with this proceeding. During the joint session and as documented in the Staff Progress Report, both Union and EPCOR agreed to a filing date in October 2017.

This decision and order will resolve the CIP-related issues that were the subject of the August 2, 2017 oral hearing. In addition, it will address those other aspects of the Preliminary Issues List that were not determined in the June 23, 2017 Partial Decision. This decision will bring Phase 1 of this proceeding to a close. EPCOR and Union will file proposals in accordance with this decision and order, and the OEB will then select one of them. A cost awards process will be established following the selection of the successful proponent.

Concerns raised by some Intervenors regarding the CIP Hearing

The School Energy Coalition (SEC) filed a letter dated August 4, 2017 expressing concern that some of the submissions at the August 2, 2017 hearing (at which intervenors did not participate) went beyond the CIP, into areas such as rate-setting and the remaining process in the proceeding. SEC referred to the written submissions on process that have already been made by intervenors, and urged the OEB to invite submissions by directly affected ratepayers on the question of permissible rate adjustments during the rate stability period. The Vulnerable Energy Consumers Coalition (VECC) sent a letter dated August 9, 2017 echoing SEC's concerns. Both SEC and VECC reiterated that the OEB should provide for interrogatories on the

proposals. On August 16, 2017, Greenfield Global Inc. (Greenfield) filed a letter with the OEB expressing similar views. Greenfield submitted that the competing proposals should contain information that will allow potential customers to make informed submissions, and requesting interrogatories.

The OEB recognizes that submissions were made by the proponents on permissible annual revenue updates at the hearing. The OEB does not consider the setting of rate-making parameters for the purpose of establishing comparable CIP proposals to be determinative of any element of the future rate-making scheme for the successful proponent. How the revenue requirement will be recovered, including the actual permissible annual revenue updates, will be decided later with the full participation of affected ratepayers. All of the following parameters that involve rate making assumptions should be considered in that context.

In respect of the process for examining the competing proposals, the OEB will determine the appropriate process once the CIP proposals have been received.

Decision on CIP Parameters

In its Partial Decision, the OEB decided to establish a CIP as the basis for determining proponents' successful revenue requirements. Both Union and EPCOR agreed on certain CIP parameters in a joint session with OEB staff. The OEB also provided for an oral hearing for areas of disagreement between the proponents on the CIP.

Presentment of the CIP Proposals

The OEB recognizes that both proponents have agreed to certain assumptions regarding CIP parameters. The common assumptions of the CIP should be explicitly included in each proponent's proposal to ensure that proponents are adhering to their agreement. However, the OEB does not expect proponents to disclose those competitively derived elements that build up the revenue requirement.

Agreed Upon Parameters

A full description of the parameters that were agreed upon can be found in the OEB Staff Report filed on July 20, 2017. The OEB has summarized the agreed upon parameters below and finds that they are appropriate:

- Communities

The CIP will provide service to the following communities: Chesley, Inverhuron, Paisley, Tiverton, Kincardine, Lucknow, Lurgan Beach, Point Clark, Ripley and the Bruce Energy Centre Industrial Park.

The OEB accepts this portion of the agreement between Union and EPCOR. As discussed later on page 10, the successful proponent will be required to serve these communities. This will ensure that the proponents' proposals are realistic and consistent with what the proponents would do if selected.

- Comparison Criteria

The proponents agreed to three comparison criteria: \$/m³, number of customer years and cumulative volume. The OEB accepts this aspect of the proponents' CIP agreement. These comparison criteria should be included in proponents' proposals. The successful proponent will be held to the comparative criteria agreed to when filing its rates application.

- Infrastructure Specifications

The proponents agreed that infrastructure specifications, such as the size of the pipeline to be built, its routing and resulting costs, will be left to competition. The OEB accepts this aspect of the CIP agreement. The OEB does not expect detailed cost information, which builds up to the revenue requirement, to be provided. The OEB does, however, expect proponents to include details of the infrastructure, including the routing and engineering, in their proposals.

- Construction Schedule

The OEB accepts the construction schedule as agreed to between Union and EPCOR, with the gas mains to all the communities to be served to be constructed within two years from the commencement of construction. The OEB finds that the timing of customer connections each year during the rate stability period will be left to competition. Proponents are expected to include their construction schedule forecast.

- Customer Attachments

Both proponents agreed that the number of attachments should be competitive, and based on the levels of risk and marketing activities that each proponent would be willing to take on. The OEB accepts this aspect of the CIP agreement and finds that the number of customer attachments will be competitive. The OEB expects proponents to include details on their forecast attachments as part of the proposals. The successful proponent will be held to its forecast for rate-making purposes.

- Forecast Horizon

The OEB accepts this aspect of the CIP agreement and finds that a 10 year horizon for customer attachment and volume forecasts is appropriate.

- Customer Consumption

The OEB accepts this aspect of the CIP agreement and finds that using common consumption levels for each mass market segment, except for large commercial or industrial customers, is appropriate. The proponents agreed to work together to develop these values. These values should be included in proponents' proposals. If the proponents are unable to agree on the values to be used, they may seek further directions from the OEB.

- Depreciation Rates

The OEB accepts this aspect of the CIP agreement and finds that any depreciation rates used should be based on Union's OEB-approved depreciation rates. The proponents should confirm the depreciation rates used in their proposals.

- Capital Structure

The OEB accepts this aspect of the CIP agreement and finds that the capital structure for both proposals should be based on Union's approved deemed debt/equity ratio of 64% / 36%. The proponents should confirm the depreciation rates used in their proposals.

However, the OEB finds that the cost of debt and return on equity (ROE) is properly considered competitive. If parties wish to use debt and ROE rates that

are different than the OEB-approved rates they can do so. The OEB finds that it will not hold Union to its existing debt rates or return on equity applied to its regulated business, and instead should consider its proposal as coming from a standalone business in the spirit of competition. The OEB does not expect the cost of debt and ROE to be provided in proponents' proposals.

- Government Grants and Municipal Contributions and Aid to Construction

Both proponents agreed to use a gross revenue requirement excluding any government grants, municipal contributions and Aids to Construction. The OEB accepts this aspect of the CIP agreement and finds that government grants and contributions from municipalities, as well as any Aid to Construction required for customers, should be excluded from the proposals.

- Demand-Side Management (DSM) Costs

Both proponents agreed to exclude DSM costs in their proposals. The OEB accepts this aspect of the CIP agreement and finds DSM costs should be excluded from the proposals.

- Cap and Trade Costs

Both proponents agreed to exclude Cap and Trade costs in their proposals. The OEB accepts this aspect of the CIP agreement and finds Cap and Trade costs should be excluded from the proposals.

- Taxes

Both proponents agreed to use common tax rates and exclude any tax holidays from the municipality from their proposals. The OEB accepts this aspect of the CIP agreement and finds that tax rates should be common and included in each proposal, and that any municipal tax holidays from the municipalities should be excluded from the proposals.

- Service Levels

Both proponents agreed to plan for operations and maintenance that would meet the service levels identified in the Gas Distribution Access Rules (GDAR). The OEB accepts this aspect of the CIP agreement. The proponents should confirm the service levels that they intend to meet in their proposals.

- Gas Commodity Costs

In their oral submissions, both proponents agreed to exclude gas commodity costs from the revenue requirement proposal. The OEB accepts this aspect of the CIP agreement and finds that gas commodity costs should be excluded from the proposals.

- Interest During Construction (IDC)

In their oral submissions, both proponents also agreed to use the OEB-prescribed rate for IDC, so that it will be common between proposals. The OEB accepts this aspect of the CIP agreement and finds that IDC rates for the proposals will be at the OEB's prescribed rate. The proponents should confirm the IDC rate used in their proposals.

- "Other" or "Intangible" Category

Both proponents agreed to the inclusion of an "Other" or "Intangible" category in their proposals that would include other non-financial issues that the OEB could take into account in its decision. The OEB accepts this aspect of the CIP agreement and finds that an "Other" or "Intangible" category is appropriate.

Areas of Disagreement between the Proponents

The OEB's findings on the unresolved areas of the CIP are set out below:

- Upstream Reinforcement

Union stated that it had instituted an "ethical wall" between Union representatives working on the competitive proposal and those in the service provision team to ensure an unbiased and objective approach, and that the same methodology for costing upstream reinforcements would be applied to both proponents' proposals. However, EPCOR submitted that it was unable to properly determine upstream costs, or control or test the costs of various supply scenarios on Union's system, which could cause wide variances in capital cost estimates for upstream reinforcements. EPCOR also noted that it would be held to a cost determined by Union through its proposal.

The OEB will exclude upstream reinforcement costs for the purposes of the CIP proposals. The future recovery of upstream costs by either proponent is based

on a common assumption that the lowest cost solution will be chosen and implemented. Where costs are considered to be common to both proponents they need not be included for selection purposes. The OEB will review these costs and their underlying assumptions in the rate case following the selection of the successful proponent.

- Inflation Costs

For the purposes of establishing the calculation of the 10-year gross revenue requirement, proponents will be allowed to apply the rate of inflation to capital and OM&A costs during the rate stability period. The OEB finds that there should be inflationary adjustments to capital and OM&A costs during the rate stability period and that inflation rates should be the same between the two proposals. The OEB accepts Union's suggested common inflation rate, which should be equivalent to the estimated long term inflation rate based on the most recent four quarter average GDP IPI FDD methodology accepted by the OEB. The GDP IPI FDD is the standard approach towards forecasting inflation. Therefore it is appropriate for these circumstances. How the revenue requirement, including allowed inflation, will be recovered will be decided later with the full participation of affected ratepayers.

To clarify, the OEB expects proponents to provide their gross revenue requirement, including inflation as noted above, in their proposals. The OEB would be assisted in seeing the revenue requirement on an annual basis, the net present value of the gross revenue requirement, and the cumulative revenue requirement.

- OM&A Costing Methodology

The OEB reaffirms the principle of fully allocated costs as set out in the Generic Decision, which prevents cross-subsidization of new expansion customers by current ratepayers. Proponents are expected to base their OM&A cost estimates on an allocation that would result from a fully allocated cost study typically filed in a full rates case. To be clear, although the OEB expects this principle will be followed, the OEB does not expect to see a full cost allocation study in proponents' proposals.

- Treatment of Capital Costs

As determined in the Generic Proceeding, the OEB finds that any capital cost overruns incurred during the first 10 years above the forecasted costs reflected in the proposals will not be permitted into the successful proponent's rate base for year 11 and beyond (following the rate stability period). The treatment will be symmetrical: cost underruns will accrue to the utility's benefit.

- Other CIP Parameters

The OEB finds that royalty payments to the municipalities will be excluded from the proposals if they are not recovered through the utility's revenue requirement. If the royalty payments are proposed to be collected from the revenue requirement, then the royalty payments must be included in the revenue requirement for the CIP.

In summary, the OEB expects proponents to provide details on the following in their proposals:

- Communities To Be Served
- Comparison Criteria
- Infrastructure Specifications (Routing and Engineering)
- Construction Schedule Forecast
- Customer Attachments Forecast
- Forecast Horizon
- Customer Consumption Levels
- Depreciation Rates
- Capital Structure
- Tax Rates
- Service Levels
- Interest During Construction (IDC)
- "Other" or "Intangible" Category
- Inflation Costs
- Royalty Payments to Municipalities (if collected from the revenue requirement)

The OEB does not expect proponents to provide details regarding the following:

- Infrastructure Costs
- Cost of Debt and Return on Equity
- Government Grants and Municipal Contributions and Aid to Construction

- Demand-Side Management (DSM) Costs
- Cap and Trade Costs
- Tax Holidays
- Gas Commodity Costs
- Upstream Reinforcement
- OM&A Costing Methodology

Decision on Other Preliminary Issues

Issue #1

This issue concerns the appropriate process for selecting a proponent when there are competing proposals for serving a community.

The OEB provided its findings on the issue in the Partial Decision and Procedural Order #6. In accordance with P.O. #6 and #7 the OEB has commenced the selection process and will base it on the parameters described in Procedural Order #6 and in this decision on the outstanding preliminary issues.

The OEB has determined that the selection process set out so far will be limited to this particular proceeding, and that the OEB will be applying the lessons learned from the process to competitive expansion applications in the future.

Issue #2

This issue concerns whether the funding of this process should be treated as a business development cost or as a regulatory expense, recoverable from future ratepayers.

OEB staff, Anwaatin, EPCOR and the Southern Bruce Municipalities supported funding the application proceeding as a business development cost.

Enbridge and Northeast Midstream submitted that an unsuccessful proponent should consider their expenses in the application proceeding as a business development cost, but that the successful proponent should be able to recover the costs from future ratepayers. Northeast Midstream stated that the recoverable amount should be less government grants received. OEB staff submitted that proponents should be able to demonstrate the separation of costs in the proponents' next cost of service application.

EPCOR submitted that while bidding expenses should be treated as a business development expense, the OEB should take into account the number and level of binding commitments it requires from proponents. EPCOR stated that in Canadian Public-Private Partnerships (P3s), vendors may offer honorariums for P3s that required considerable effort to develop bids for.

CCC supported funding the application proceeding as a business development cost, but submitted that if it were determined to be a regulatory expense, it should be recovered from ratepayers in the relevant communities. Union submitted that the cost of the proceeding should be a business development cost recoverable from future ratepayers. SEC submitted that the successful proponent's reasonable expenses should be treated as a regulatory expense recovered from future ratepayers.

VECC invoked fairness in terms of either allowing the costs of both applicants to be included in the recovery of ratepayers, or allowing neither party to recover these costs. VECC also suggested that the OEB could allow both parties to recover a pre-determined set amount of "business development costs" to be recovered in a regulatory fee adder, which either applicant could waive to make their proposal more attractive.

The Southern Bruce Municipalities referred to their own competitive procurement process, where the preparation of proposals by potential distributors was treated as a business development expense, which they observe did not serve as a disincentive to proponents.

The OEB considers the activities related to determining business interests and participating in a selection process to be business costs incurred for the potential benefit of shareholders and therefore not recoverable in rates.

Issue #3

In the Partial Decision, the OEB determined that a rate stability period of 10 years was appropriate, but did not decide whether proponents should have the opportunity to update costs during the rate stability period.

For the purpose of structuring a common platform for selection purposes, the OEB finds that proponents should price their revenue requirement proposals based on the assumption that there will be no rate adjustments during the 10-year rate stability period, other than the availability of Z-factor relief for certain events that fall within the OEB's policy. Any Z-factor proposals will be reviewed based on the criteria delineated in the OEB's Filing Requirements for Natural Gas Rate Applications:

- Causation – The cost increase or decrease, or a significant portion of it, must be demonstrably linked to an unexpected, non-routine event and must be clearly outside of the base upon which rates were derived
- Materiality – The cost increase or decrease must meet a materiality threshold, in that its effect on the utility's revenue requirement in a fiscal year must be equal to or greater than the established threshold
- Prudence – The cost subject to an increase or decrease must have been prudently incurred
- Management Control – The cause of the cost increase or decrease must be: (a) not reasonably within the control of utility management; and (b) a cause that utility management could not reasonably control or prevent through the exercise of due diligence

The OEB's existing approach to Z-factor updates will be applied on an ongoing basis.

Issue #4

This issue concerns the format for proposals to serve a community, including whether there should be filing requirements. This issue has now been addressed through the OEB's findings in the Partial Decision and the findings above in respect of the CIP.

Issue #5

This issue concerns how the costs of competing proposals should be compared. As explained above in the section on the CIP parameters, the proponents agreed that the costs should be compared based on three criteria – \$/m³, number of customer years, and cumulative volume – and the OEB agrees. As noted above, the OEB would be assisted in seeing the revenue requirement on an annual basis, the net present value of the gross revenue requirement, and the cumulative revenue requirement.

Issue #6

This issue concerns whether measures should be put in place to ensure completion of the proposed projects, and if so, what those measures should be.

The OEB finds that the winning proponent must serve all the communities identified in the CIP, with the gas mains to all the communities to be served to be constructed within two years from the commencement of construction. The precise measures to be put in place to ensure that this occurs can be determined in due course.

It is necessary to make provision for the following matters related to this proceeding. Further procedural orders may be issued by the OEB.

IT IS THEREFORE ORDERED THAT:

1. EPCOR Southern Bruce Gas Inc. and Union Gas Limited shall submit their proposals for serving the area covered by the South Bruce Expansion Applications on **October 16, 2017**. The format and substance of the proposals shall conform to the directions set out in this decision. To ensure fairness as between the two proponents, the submissions will be received in confidence and will be made publicly available on the next business day.

All filings to the OEB must quote the file numbers, EB-2016-0137 | EB-2016-0138 | EB-2016-0139, be made in searchable / unrestricted PDF format electronically through the OEB's web portal at <https://www.pes.ontarioenergyboard.ca/eservice/>. Two paper copies must also be filed at the OEB's address provided below. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at <http://www.oeb/Industry>. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of the Registrar at the address below, and be received no later than 4:45 p.m. on the required date.

With respect to distribution lists for all electronic correspondence and materials related to this proceeding, parties must include the Case Manager, Azalyn Manzano at Azalyn.Manzano@oeb.ca and OEB Counsel, Michael Millar at Michael.Millar@oeb.ca.

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DATED at Toronto, **August 22, 2017**

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary