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January 25, 2018

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
P.O. Box 2319  
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Toronto ON M4P 1E4

Dear Ms. Walli:

**Re: 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  
Board File Numbers EB-2016-0137 | EB-2016-0138 | EB-2016-0139**

Please find attached OEB staff's submission in the above-noted proceeding.

Yours truly,

*Original signed by*

Azalyn Manzano  
Case Manager

/ attach.



# **ONTARIO ENERGY BOARD**

## **OEB STAFF SUBMISSION January 25, 2018**

### **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**

**EB-2016-0137 | EB-2016-0138 | EB-2016-0139**

## INTRODUCTION

EPCOR Southern Bruce Gas Inc. (EPCOR) filed applications with the OEB on March 24, 2016 under sections 8 and 9 of the Municipal Franchises Act seeking approval for its franchise agreements with and Certificates of Public Convenience and Necessity (certificates) 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 that it was interested in serving the areas.

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.

To assist in identifying the specified service for the South Bruce community expansion, the OEB decided to establish a Common Infrastructure Plan (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 on July 13, 2017. The OEB also provided for an oral hearing on August 2, 2017 for areas of disagreement between the proponents on the CIP.

The Decision on Preliminary Issues and Procedural Order No. 8 (Decision and P.O. 8) determined that the jointly established CIP parameters were appropriate, resolved the CIP-related issues that were the subject of the August 2, 2017 oral hearing, and addressed those other aspects of the Preliminary Issues List that were not determined in the June 23, 2017 Partial Decision and Procedural Order No. 6 (the Partial Decision). In accordance with the Decision and P.O. 8, both EPCOR and Union filed proposals to serve the area covered by the South Bruce applications on October 16, 2017.

Subsequent to the filing of the CIP proposals, in a letter dated October 20, 2017 Union Gas expressed concern that the proponents were using different definitions of "volume" which created a misalignment for comparison purposes between key comparison metrics noted in the CIP proposals. In a subsequent letter dated

October 25, 2017 Union Gas Union submitted that the OEB should give no weight to the volume metrics provided in the CIP proposals.

Through Procedural Order No. 9 (P.O. 9), the OEB determined that it would be assisted by limited interrogatories for the purposes of clarification. A list of proposed interrogatories was provided in Appendix A to P.O. 9, and the OEB invited parties that had any other interrogatories, which they believed to be absolutely necessary to assist the OEB in its deliberations, to be submitted to the OEB for consideration.

The OEB reviewed all proposed interrogatories submitted by the parties and on December 22, 2017, issued interrogatories to the proponents. The OEB consolidated questions to avoid repetition, and edited for clarity and to comply with the OEB's directions concerning competitive aspects of the applicants' proposals. The interrogatories included clarifying questions and requested additional information related to revenue requirement, customer attachments, volumes, indigenous issues and infrastructure.

As per P.O. 9, responses from both proponents were filed on January 11, 2018. Union Gas provide a corrected response to one interrogatory on January 12, 2018.

OEB staff reviewed the CIP proposals and interrogatory responses of both proponents and makes the following submissions.

## **SUBMISSIONS**

### **Selection Criteria**

In its Partial Decision issued on June 23, 2017, the OEB explained that the selection criteria could be restricted to a comparison of revenues required for a specific identified service:

In consideration of the numerous submissions on the issues list and the draft filing guidelines, the OEB has determined that it is appropriate in this case to grant Certificates of Public Convenience and Necessity, on a conditional basis (subject to subsequent technical and financial acceptance), to the proponent that demonstrates it has the lowest overall revenue requirement to provide an identified distribution service

in the municipalities seeking that service. The primary benefit of the introduction of competition identified in the generic decision is the discipline it instills to control costs and the search for efficiencies in system expansion and operation. All other matters related to cost allocation, rate design and the general management of the utility are ongoing concerns of the OEB which it manages as a matter of course with all regulated entities. The selection criteria can therefore be restricted to a comparison of revenues required for a specific identified service.

The Partial Decision went on to request that as part of the joint session to establish a CIP, proponents and OEB staff develop parameters to compare proposals:

The proponents and OEB staff must also determine other parameters as necessary to allow the proponents to file an application based on the CIP that will facilitate a meaningful comparison of the proposals and embody the policy objectives pertaining to positive outcomes for customers previously described.

As summarized in OEB staff's CIP Progress Update, filed July 20, 2017, the proponents expressed concern with the selection of a single criterion and instead suggested three alternate criteria be used for the purposes of comparing proposals – one of which would take into account revenue requirement.

The proponents agreed to three criteria for comparison purposes. Based on the group's understanding of Procedural Order No. 6, parties agreed that the successful proponent would be held to these criteria after adjusting them to account for any grant from the Natural Gas Grant Program and cap and trade costs (as identified below), in their future rate and LTC applications. Proponents agreed that selection of only a single criterion provides an opportunity for gaming. For example, simply selecting revenue requirement  $\$/\text{m}^3$  as the decision metric could provide an incentive for proponents to only select service to the most profitable customers, whereas proponents understand that the goal of community expansion is to facilitate access to natural gas services to many customers.

The proponents agreed to be held to these three CIP criteria and assume any risk associated with not achieving them over the ten-year rate stability period. The OEB accepted the CIP criteria in its Decision and P.O. 8:

The proponents agreed to three comparison criteria:  $\$/m^3$ , 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.

In addition, in its Decision and P.O. 8, the OEB stated:

... the proponents agreed that the costs should be compared based on three criteria –  $\$/m^3$ , 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.

### CIP Criteria

OEB staff submits that in combination, the three CIP criteria adopted by the OEB are intended to provide a balanced means of assessing the proposals and selecting a proponent. The  $\$/m^3$  CIP Comparison Criteria provides a relatively clear picture of value for money, as it shows, on average, what customers could expect to pay on a per unit basis.<sup>1</sup> The other two CIP Comparison Criteria measure the relative benefit of the proposals to the communities in terms of how quickly customers get service and their potential for fuel savings.<sup>2</sup> The emphasis on volume in these metrics also encourages the successful proponent to attach as many customers as possible.

- a) *Cumulative 10-year revenue requirement per unit of volume.* Generally speaking, this metric is akin to an overall distribution rate (i.e.  $\$/m^3$ ), and in that sense lower is better. A comparison of the CIP proposals and

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<sup>1</sup> Details of a cost allocation study would determine what costs each rate class would be expected to pay. Depending on how costs are allocated to the rate classes, there could be large differences in, for example, residential rates.

<sup>2</sup> Given that natural gas is less expensive than most competing fuels, volumes consumed are a proxy for fuel cost reduction (the more natural gas consumed the greater the fuel cost reduction).

proponents' interrogatory responses shows that EPCOR's metric is lower. This is true even when EPCOR recalculates using a normalized average consumption (NAC) approach for industrial customers (as Union Gas did in its CIP proposal) and Union Gas recalculates to adjust volumes to ten calendar years.

- b) *Customer years*. This metric is calculated as the cumulative number of customers connected over the 10-year rate stability period multiplied by the number of years each customer is connected. It is a measure of the number of customers being served and the amount of their fuel cost savings, and in this sense higher is better. Based on a comparison of the CIP proposals and the proponents' interrogatory responses, Union Gas' metric is higher than EPCOR's. This is true even when EPCOR recalculates using a NAC approach for industrial customers (as Union Gas did in its CIP proposal) and Union Gas recalculates to adjust volumes to ten calendar years.
- c) *Cumulative 10-yr volume*. Based on a comparison of the CIP proposals as well as the proponents' interrogatory responses, this metric is calculated as the cumulative volume of throughput per year, over the ten-year rate stability period. It is a measure of fuel cost savings and in this sense higher is better. Based on the CIP proposals, as well as the proponents' interrogatory responses, EPCOR's metric is higher. This is true even when EPCOR recalculates using a NAC approach for industrial customers (as Union Gas did in its CIP proposal) and Union Gas recalculates to adjust volumes to ten calendar years.

OEB staff submits that the recalculated metrics related to the hypothetical scenario of no industrial customers, as provided through interrogatory responses, should be given very little or no weight. OEB staff does not believe that this is reflective of proponent's plans to serve the area.

### **Other Metrics**

OEB staff has provided a summary of the results of the other revenue requirement and customer attachment metrics not included as part of the CIP criteria.

#### *Other Revenue Requirement Metrics*

A number of factors that determine revenue requirement are common between the two proponents as part of the CIP (e.g., equity thickness, interest, depreciation, taxes). For this reason, the proponent with the lower capital expense, lower OM&A and/or lower return on equity (ROE) (i.e., lower hurdle rate or higher risk tolerance) will tend to have a lower revenue requirement. Assuming all proponents are equally competent and offer comparable quality (which in this case they appear to be), a lower revenue requirement generally means more value per dollar for the ratepayer (i.e., lower is better) - assuming that customer numbers and volumes are also comparable.

- a) *Net Present Value (NPV) of 10-year Revenue Requirement.* Based on a comparison of the CIP proposals as well as the proponents' interrogatory responses, in all cases (i.e. the various scenarios that the OEB's clarifying interrogatories sought to examine) Union's metric is lower than EPCOR's.
- b) *Cumulative 10-year Revenue Requirement.* Based on a comparison of the CIP proposals as well as the proponents' interrogatory responses, in all cases Union's metric is lower than EPCOR's.
- c) *NPV of 10-year Revenue Requirement per metre of pipe (\$/m).* Based on a comparison of the CIP proposals as well as the proponents' interrogatory responses, in all cases, Union's metric is lower than EPCOR's.

#### *Customer Attachment Metrics*

Customer attachment metrics may be seen as a reflection of a proponent's confidence in the strength of the market (via market research or other means) and/or their own abilities to attract customers. Generally speaking, higher is better.

- a) *Forecasted Residential Customer Attachment Rate.* Union Gas' residential customer attachment rate is higher than EPCOR's at 71% vs. 60%, respectively. In terms of the pacing of customer attachments, EPCOR and Union Gas appear to be facilitating attachments at approximately the same rate, with approximately 90% of attachments occurring in the first five years.

OEB staff notes that Union Gas' customer attachment rate is consistent with attachment rates filed by Enbridge Gas Distribution Inc. in evidence as part



of the Generic Community Expansion Proceeding.<sup>3</sup> OEB staff notes that the risk of not achieving the forecast attachment rate may be passed to ratepayers at the end of the ten-year rate stability period.

- b) *Forecasted Commercial Customer Attachment Rate.* Union Gas' commercial customer attachment rate is higher than EPCOR's at 72% v. 65%, respectively. In terms of the pacing of customer attachments, EPCOR and Union Gas appear to be facilitating attachments at the same rate, with approximately 90% of attachments occurring in the first five years.
- c) *Customers per kilometer.* Union Gas' average number of customers per kilometer is higher than EPCOR's at approximately 21 customers/km versus approximately 17 customers/km, respectively.

### **Other Value Added Factors**

One further consideration when evaluating the proposals of EPCOR and Union may be other value added factors that the proponents have described in their proposals. For example, EPCOR proposes to work with the Municipality of Kincardine's wastewater division and Bruce Telecom on various projects related to wastewater, fibre optic, and other services given that it is an integrated utility company. Although these activities may be of significant benefit to the South Bruce communities, OEB staff submits that the OEB may wish to consider the weight that should be placed on these type of commitments as they fall outside the OEB's mandate.

### **Order to be Granted**

In the Generic Community Expansion Decision, the OEB noted that facilitating the entry of new participants and allowing for competition through new rate zones would be accomplished by considering the proposed rates for a potential service area in a leave to construct hearing<sup>4</sup>. The OEB's Generic Community Expansion Decision further stated that,

...for any community expansion proposal under the OEB's alternative framework, a review of the proposed rates will be required prior to

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<sup>3</sup> EB-2016-0004. Refer to Enbridge Gas evidence filed 2016-03-21, Table 4.

<sup>4</sup> EB-2016-0004, page 19.

approval of the franchise and Certificate. This will allow the OEB to review pertinent information regarding the proposal including forecast attachment rates, cost allocation, rate design, pipeline route and system reinforcement plans prior to approval of the franchise agreement and Certificate. This approach will also allow proponents to compete for the franchise if they wish to do so. The OEB will entertain multiple applications and approve the proposal that best meets the needs of the community and ratepayers.

The Generic Community Expansion Decision also envisioned that a review of attachment rates, pipeline routes and other information would be part of a rate/leave to construct application that would be approved before or in conjunction with a franchise agreement and certificate.

Although leave to construct and rate approval will be required by the successful proponent in the future, OEB staff is of the view that much of the pertinent information intended for review has been discussed as part of this proceeding. In addition, it is OEB staff's view that the intent of not granting franchise agreements or certificates until leave to construct/rate approval was received was to avoid a situation where certificates have been issued but areas remain unserved. OEB staff submits that both proponents, if successful, intend to serve the South Bruce communities as soon as possible.

Moreover, OEB staff believes that any concern about a proponent not moving forward with service to the South Bruce communities after being granted the franchise agreement and certificate can be alleviated by placing a condition on the selection of the successful proponent and awarding of the franchise agreement and certificate, as more fully described in the Proposed Conditions below.

As noted above, the OEB determined in the Partial Decision that it is "appropriate in this case to grant Certificates of Public Convenience and Necessity, on a conditional basis (subject to subsequent technical and financial acceptance)". Given Union Gas' long history of natural gas distribution in Ontario and the OEB's recent approval of the transfer of Natural Resource Gas Limited's natural gas distribution system to EPCOR's related company EPCOR Natural Gas Limited Partnership<sup>5</sup>, OEB staff submits that such a review is unnecessary for this case. In

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<sup>5</sup> EB-2016-0351

this case, rather than granting the certificates on a conditional basis subject to a subsequent third phase to determine technical and financial acceptance, OEB staff is of the view that it is appropriate to issue a final order to the successful proponent approving franchise agreements with and certificates for the Municipality of Arran-Elderslie, Municipality of Kincardine and the Township of Huron-Kinloss, which includes the proposed conditions of approval below.

### **Proposed Conditions**

The OEB decided in its Decision and P.O. 8 that the winning proponent must serve all the communities identified in the CIP, with the gas mains to all the communities to be served being constructed within two years from the commencement of construction.

In order to ensure that gas flows as soon as possible, OEB staff submits that the certificate should be awarded on two conditions. First, that the successful proponent files a leave to construct application within six months of the decision to award the certificate. Second, that the subsequent approval of the leave to construct application is granted. OEB staff is of the view that six months is reasonable for the filing of the application given that both proponents have indicated that they would be able to file a leave to construct application well within this time frame. While OEB staff recognizes that the successful proponent would be incentivized to provide gas service as soon as possible, applying these conditions would provide further assurance that the certificate will not be awarded and then go unused.

**All of which is respectfully submitted.**