EB-2018-0305

ONTARIO ENERGY BOARD

IN THE MATTER OF the Ontario Energy Board Act,
1998, S.O. 1998, c.15 (Sched. B);

AND IN THE MATTER OF an Application by Enbridge Gas Distribution Inc.
and Union Gas Limited (to amalgamate into Enbridge Gas Inc. effective January 1, 2019), pursuant to section 36(1) of the *Ontario Energy Board Act, 1998*, for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas as of January 1, 2019.

Enbridge Gas Inc. 2019 Rates

Argument Submission of

Energy Probe Research Foundation

July 4, 2019

Argument Submission of

Energy Probe Research Foundation

Energy Probe has seen the submissions of some of the other intervenors. In order to avoid duplication, Energy Probe will limit its submissions to only a few of the unsettled issues.

Issue 5. Should the proposed changes be made to the accounting orders for the following deferral accounts?

EGD Rate Zone
a. 179.24 Post Retirement True-up Variance Account
b. 179.48 Open Bill Revenue Variance Account
c. 179.08 Ex-Franchise Third Party Billing Services Deferral Account
d. 179.70 Purchased Gas Variance Account
e. 179.88 Storage and Transportation Deferral Account
f. 179.94 OEB Cost Assessment Variance Account

Union Gas Rate Zones
g. 179-136 Parkway West Project Costs
h. 179-137 Brantford-Kirkwall/Parkway D Project Costs
i. 179-142 Lobo C Compressor/Hamilton to Milton Project Costs
j. 179-144 Dawn H/Lobo D/Bright C Compressor Project Costs
k. 179-149 Burlington Oakville Project Costs
l. 179-156 Panhandle Reinforcement Project Costs

Energy Probe Submission

Regarding item b. 179.48 Open Bill Revenue Variance Account, Energy Probe believes that the OEB should defer decision on this account pending the outcome of the EB-2018-0319 proceeding which is dealing with the Open Bill Access Program.

Issue 9. Do the USP and AMPs support approval of the ICMs?

Energy Probe Submission

From the USP and AMP evidence it is not clear why these four projects were selected for ICM funding applications. There is nothing special about these projects except, perhaps, their size.[1] Energy Probe submits that the USP and AMP evidence does not support approval of these specific ICMs.

Issue 10. Are the costs of the ICM projects appropriate, to the extent that they differ from the costs considered by the OEB in granting leave to construct?

Energy Probe Submission

Energy Probe believes that there are numerous problems with the cost estimates of the proposed ICM projects. Let us look at each one in turn as they are presented in a response to Energy Probe.[2]

<u>Don River Replacement</u>

The cost of the project approved by the OEB in the Leave to Construct application EB-2018-0108 was $25.6 million. The updated cost estimate is now $35.4 million, an increase of $9.8 million, or 38.6%. By any measure this is a very large increase in the cost estimate. [3]

The largest driver of the increase is Overhead Costs which increase from $759 thousand to an astounding $9.989 million, an increase of $9.23 million. The largest cause of the increase in the project cost is not some unforeseen external cause but a gigantic allocation of corporate overheads. These are not direct overheads that are related to specific activities related to this project but are the allocated costs of administrative and head office departments. There is no evidence that any of these departments had to hire additional staff or had to incur incremental costs because of the Don River Replacement project. A company witness made it clear that this was just a re-allocation of previously budgeted overheads from Company's other projects to the

[1] Exhibit C1, Tab 1, Schedule 1, Table 1, Page 49
[2] I.EP.16
[3] I.EP.16, page 2

Don River Replacement[4]. However, there is no evidence that the Company has reduced the overheads charged to other capital projects by $9.989 million. Therefore, it seems that this is a case of double recovery. The Company wants to recover the $9.989 million through overheads charged to its other capital projects and then wants to get it the second time through the $9.989 charged to the Don River Replacement Project.

The second largest driver is the increase in Land costs from $301 thousand to $2.265 million an increase of $1.964 million or 652.5%. It seems that land acquisition costs were very poorly estimated. As the Board knows, the Company is engaged in expropriation for the land.[5] That this was unforeseen calls into question the experience and competence of the people responsible for the estimate. The project is located at the foot of Don Valley Parkway in an extremely congested area. It seems naïve that land could be obtained there for only $301 thousand.

The third largest driver of the increase is in External & Regulatory costs from $860 thousand to $1.434 million, an increase of $573.5 thousand. According to the Company this was largely caused by the legal and OEB proceeding costs of expropriation.

The original estimate of Contingency for the project was $5.699 million and $3.687 million remains. The Company used up $2.011 million. Considering that the project is 38.6% over the OEB approved estimate in the LTC proceeding, it is not clear why did the Company not use more of the Contingency to offset the increase.

Energy Probe believes that OEB should reduce the project cost by the $9.230 variance in Overhead Costs. That would bring it down to $26.125 million. If should then take $527 thousand from the unused Contingency to bring the cost down to the cost estimate approved in the LTC proceeding. That would still leave the Company with $3.161 million of Contingency to deal with unforeseen events during construction.

<u>Sudbury Preplacement</u>

[4] Technical Conference, May 1, 2019, Tr. Page 59
[5] Technical Conference, May 2, 2019, Tr. Page 8

This project was completed and in service in October 2018, so the costs presented are essentially actual costs. The project cost approved in the LTC application EB-2018-0180 was $74.057 million and the final cost was $95.257 million, an increase of $21.2 million or 28.6%. The largest driver of the increase in costs was allocation of $12.3 million of Overheads to the project in the Updated Cost Estimate[6]. The original cost estimate did not include any amount for Overheads. Why was that done? Did Union Gas deliberately underestimate project costs to obtain OEB approval, or were overhead costs incurred in 2018 already allocated to other Union Capital Projects. Energy Probe believes that the latter is the correct explanation. However, if it is, then the 2019 allocation of the $12.3 million of Overheads to this project that was completed in 2018 is clearly double counting. It may also be contrary to accounting rules since out of period OM&A costs are being capitalized as Overheads. The OEB should reduce the cost estimate by $12.3 million to $82.957 million.

Kingsville Project

The OEB approved a cost estimate of $105.716 million in the EB-2018-0013 LTC application. The Updated Cost Estimate is $124.16 million, an increase of $15.700 million or 14.9%. The entire increase is due to the allocation of $15.7 million in Overheads to the project[7]. As in the Sudbury Replacement project, the original cost estimate did not include and Overheads costs. As in the Sudbury Replacement Project it is likely that there were no Overheads costs included in the original cost estimate because these costs were already allocated to other capital projects in the Union Gas' 2018 budget. Allocating them now to the Kingsville Project would result in double recovery. There are other peculiarities in the cost estimate of this project. Although months have passed since the OEB approval of the project in EB-2018-0013, there have been no changes shown in the Updated Cost estimate for Construction & Labour. If the construction started in May, the Company must have awarded the contract prior to May and should have a better estimate of the Construction & Labour costs. It is highly unlikely that these costs would be exactly as estimated in the EB-2018-0013 application. This raises questions about the credibility of the estimate for this project. The OEB should reduce the estimate by the $15.7 Overheads allocation to the original approved amount of $105.716 million.

[6] I.EP.16, page 3
[7] I.EP.16, page 4

Stratford Reinforcement

The cost estimate for this project stands out because it is so different than the other three projects. The original cost approved by the OEB in EB-2018-0306 LTC application was $28.54 million and the Updated Cost Estimate is exactly the same[8]. There were no overheads allocated to the project in either the original estimate as filed in EB-2018-0306 nor in the Updated Cost Estimate. While Energy Probe believes that the OEB should approve the cost of this projects as filed, it is not clear why the other three projects were allocated large costs for Overheads and this project was not. The Company did not provide any reasons for this peculiarity.

Issue 11. Is the NPS 30 Don River Replacement Project in the EGD rate zone eligible for Incremental Capital Module (ICM) funding?
a. If yes, is the ICM rate rider for the NPS 30 Don River Replacement Project calculated appropriately?

Issue 12. Are the Sudbury Replacement Project in the Union North rate zone and the Kingsville Transmission Reinforcement and Stratford Reinforcement projects in the Union South rate zone eligible for ICM funding?

Energy Probe Submission

The following is the submission of Energy Probe on Issues 11 and 12. At the start of incentive regulation (originally called performance-based regulation or PBR) of electricity and gas distributors by the OEB, there was no provision for a rider that would fund capital expenditures. Initially the method used by the OEB was referred to as Comprehensive PBR to indicate that both capital and OM&A were to be set by a rate setting I-X Price Cap formula that took into account inflation "I" and productivity "X". Electricity distributors were expected to fund all their capital expenditures through rates produced by the application of the formula while gas distributors were allowed to propose their own PBR models.

[8] I.EP.16. page 5 and JT2.7

This seemed to work reasonably well for a few years until the 2013 ice storm caused some electricity distributors to incur large and unexpected capital expenditures to replace damaged facilities. It should be noted that gas distributors were largely unaffected by the 2013 ice storm and did not incur large expenses. In response to the expenses incurred by electricity distributors the OEB put in place a method, the Incremental Capital Module, ICM, that would allow distributors to deal with such large and unexpected expenditures in the future by funding them through rate riders to be charged to ratepayers. The OEB did not make ICM available to gas distributors.

Over the years since the ICM was introduced, the criteria for projects that would be accepted for ICM treatment has changed several times as a result of demands from electricity distributors. These changes came about through OEB reports or OEB decisions in specific cases. It seems to Energy Probe that each change further opened the door to what projects were acceptable for ICM treatment. Gas distributors were never eligible for ICM funding of capital projects. This all changed with the OEB decision in the Enbridge Union merger case[9] where the merged utility, now known as Enbridge Gas Inc. applied for and received approval to be eligible for ICM funding of capital projects. In this application Enbridge is testing the limits of that approval with applications for ICM funding for four capital projects. When considering EGI's application the OEB should keep in mind its previous decisions on ICM eligibility.

The Board is of the view that projects proposed for incremental capital funding during the IR term must be discrete projects, and not part of typical annual capital programs. This would apply to both ACMs and ICMs going forward.[10]

In addition, the OEB finds that a discrete project is not simply one that is distinguishable or defined at a new location - or all capital would be eligible. ICM projects do need to be different in kind from those that are carried out through typical base capital programs. Otherwise, the OEB would need to scrutinize all capital projects for optimization, not just the ICM projects.[11]

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[9] EB-2017-0306/0307 Decision, Page 32

[10] EB-2014-0219, *Report of the Board New Policy Options for the Funding of Capital Investments: The Advanced Capital Module*, September 18, 2014, page 13

[11] EB-2017-0024 Decision, April 6, 2018, Page 27

The OEB's ICM policy does not make ICM funding available for typical annual capital programs. It is also not available for projects that do not have a significant influence on the operations of the distributor. The ICM is intended to address the treatment of a distributor's capital investment needs that arise during the Price Cap IR rate-setting plan which are incremental to a materiality threshold. [12]

The ICM is available for discretionary and non-discretionary projects, as well as for capital projects not included in the distributor's previously filed Distribution Supply Plan. It is not limited to extraordinary or unanticipated investments.

In order to qualify for ICM funding, a request must satisfy the eligibility criteria of materiality, need and prudence, as set out in section 4.1.5 of the ACM Report. Changes to the materiality threshold were made in the Supplemental Report.

Materiality

There are two materiality tests related to ICM applications. The first test is the ICM materiality threshold formula, which serves to define the level of capital expenditures that a distributor should be able to manage within current rates. The test states that: "Any incremental capital amounts approved for recovery must fit within the total eligible incremental capital amount" and "must clearly have a significant influence on the operation of the distributor".

Need

The ACM Report indicated that need must be established by meeting the following criteria:

- *passing the Means Test*
- *the amounts must be based on discrete projects, and should be directly related to the claimed driver*
- *the amounts must be clearly outside of the base upon which the* rates were derived.

[12] EB-2018-0016 Decision, January 31, 2019, Pages 4 and 5

Under the Means Test, if a distributor's regulated return exceeds 300 basis points above the deemed return on equity embedded in the distributor's rates, then the funding for any incremental capital project would not be allowed.

Prudence

The ACM Report specifies that the amounts to be incurred must be prudent, which means that a distributor's decision to incur the amounts must represent the most cost effective option (but not necessarily the least initial cost) for ratepayers.[13]

Let's look at the proposed ICM projects listed in Issues 11 and 12 to see if they meet the ICM criteria or conform with previous OEB decisions. But first, Energy Probe would like to comment on the inconsistency of the calculation of the ICM threshold between the EGD and Union rate zones. In its threshold calculation, the Company used a PCI f of 1.07% for the EGD rate zone and a PCI of 0.72% for the Union rate zone. The 1.07% is the PCI for 2019 which will be used to set rates, while 0.72% is the average of annual PCI's used by Union Gas since 2014. This inconsistency benefits the Company by lowering the ICM threshold for the Union rate zone. One wonders if the Company would be asking for this if the average of Union's past PCI's was higher than 1.07%. Energy Probe is not aware of any OEB decision where a different PCI was approved for calculating the ICM threshold than for setting rates. If the OEB approves this novel and self-serving change in the calculation of ICM thresholds it will be setting a precedent that will likely be used by other distributors. Energy Probe submits that the OEB should reject the Company's proposal to use different PCI's for ICM threshold calculation than for rate setting.

For the Don River replacement project, EGI is seeking $13 million in ICM funding from ratepayers. If the OEB adjusts the cost of this project, as suggested by Energy Probe in its submission on Issue 10, by removing the variance in Overheads of $9.230 million and $527 thousand in Contingency, one is left with $3.243 million which is below Enbridge's materiality threshold of $10 million. The Don River Replacement project does not meet the Materiality test. However, if we accept the Company's cost estimate as filed in this proceeding, the cost of Don River Replacement project is 36.8% over its OEB approved budget in the LTC proceeding. This

[13] EB-2018-0016 Decision, January 31, 2019, Page 8

calls into question the prudence of the project. For these reasons, Energy Probe submits that the Don River Replacement Project fails to meet the OEB's criteria for ICM projects and should not be approved for ICM funding.

The Sudbury Reinforcement Project also fails the test for ICM approval. The project costs as filed are 28.6% above the costs approved in the LTC. Energy Probe believes that as a result, the project fails the test of Prudence. The project was completed in 2018. While it was needed in the past, there is no current need for this project in the future since it was already completed. If this 2018 project were to qualify for ICM in 2019, then many large projects from past years would also qualify. Approving this out of period project would be an invitation to electricity distributors to apply for their historical projects too. The OEB should not approve this project for ICM funding.

Except for the submission under Issue 9 above, Energy Probe has no objections to the ICM funding for the Kingsville project if the project cost is reduced to the cost estimate approved by the OEB in the LTC proceeding, and the rate setting PCI of 1.07% is used in the ICM threshold calculation.

Energy Probe believes that the Stratford Project is a routine project, similar to other projects that Union Gas has completed for years without ICM funding and it is not clear why ICM funding is needed now. Taking into account the relatively low cost of the project, EGI should be able to fund the construction of this project without any additional money from ratepayers.

Respectfully Submitted,

Tom Ladanyi
Consultant to Energy Probe