ONTARIO ENERGY BOARD

STAFF SUBMISSION

ON THE BOARD'S OWN MOTION TO REVIEW THE TOTAL CAPITAL COSTS OF THE IGPC PIPELINE
EB-2012-0396

October 22, 2012

I. Background

On May 17, 2012, the Board issued its final decision and order with respect to a rates application (EB-2010-0018) by Natural Resource Gas Ltd. ("NRG"). Integrated Grain Processors Co-operative Inc. ("IGPC") was an intervenor in that proceeding. IGPC operates an ethanol facility in NRG's service territory, and is an NRG ratepayer.
In a previous proceeding (EB-2006-0243), the Board had granted NRG leave to construct a dedicated pipeline to serve IGPC's ethanol facility. A Pipeline Cost Recovery Agreement ("PCRA") was executed between IGPC and NRG which detailed, amongst other things, the amount of the capital contribution IGPC would be required to pay NRG for the construction of the pipeline. The formula used to derive the capital contribution was consistent with the Board's formula and guidelines as established in the 1998 E.B.O. 188 proceeding. The PCRA required IGPC to pay an amount "up-front" that would later be reconciled against actual costs once construction was completed. The up-front payment by IGPC was $3,538,792.47. In the event of a dispute between the parties regarding the total actual costs, the PCRA provided two possible remedies: a dispute resolution clause which named the Board as arbitrator, and a separate clause which stated that all disputes arising out of the agreement were the exclusive jurisdiction of the courts of Ontario.

The pipeline was completed and began supplying gas to the ethanol facility in July 2008. Since that time, there has been an ongoing dispute between IGPC and NRG regarding the actual costs of constructing the pipeline. This issue is important to IGPC as they believe that they are entitled to a refund on the disputed costs as part of the reconciliation provisions of the PCRA.

IGPC sought to raise this issue in the EB-2010-0018 proceeding. It filed a motion asking the Board to consider the prudency and reasonableness of the total costs of the pipeline as claimed by NRG. To the extent the claimed costs were excessive, IGPC argued it would be entitled to a refund of some portion of its capital contribution.

The Board declined to hear some of the issues identified in the motion. Although it did make a determination with respect to the pipeline costs that entered NRG's rate base (which therefore comprised part of NRG's final rate order), it did not make any assessment of the total reasonable pipeline costs, or the proper amount of IGPC's capital contribution. At pages 14-15 the Board stated:

> The Board can only act in accordance with those powers specifically provided by legislation, either directly or through the doctrine of necessary implication. The Board has no legislative authority to act as an arbitrator for contractual disputes, and no provision of a contract (such as Article IX to the PCRA) can give the Board such a power. The Board has no further statutory powers to resolve the remaining issues concerning the total costs of the pipeline. […] IGPC is seeking a refund. The issue between IGPC and NRG is essentially a contractual dispute between two private entities. The Board does not have jurisdiction to consider or remedy contractual disputes.

On June 18, 2012 IGPC appealed this portion of the Board's decision to the Divisional Court.

On October 4, 2012, the Board, on its own motion, issued a notice of motion to review the EB-2010-0018 decision, in particular with regard to the capital contribution issue. The Board invited submissions from parties on the following questions:

> Does the Board have the jurisdiction to determine the proper amount of the capital contribution owed from IGPC to NRG, including any refund that may be owed by NRG to IGPC? If the answer to this question is "yes", what steps, if any, should the Board take to address this situation?

In its submission on this issue in the EB-2010-0018 proceeding, Board staff argued that the Board lacked jurisdiction to determine the total amount of the capital contribution.

Board staff has reconsidered this opinion, and offers the following analysis for the Board's consideration.

II. The Legislative and Regulatory Framework

The purpose of regulation

One of the key purposes of regulation in the energy sector is to protect consumers from the exercise of monopoly power. In *ATCO Gas & Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, the Supreme Court stated:

> Public utilities are typically natural monopolies: technology and demand are such that fixed costs are lower for a single firm to supply the market than would be the case where there is duplication of services by different companies in a competitive environment. […]The utility regulations exist to protect the public from monopolistic behaviour and the consequent inelasticity of demand while ensuring the continued quality of an essential service.[1]

The relationship between the utility and its customers is governed by the "regulatory compact". As described by the Supreme Court, "Under the regulatory compact, the regulated utilities are given exclusive rights to sell their services within a specific area at rates that will provide companies the opportunity to earn a fair return for their investors. In return for this right of exclusivity, utilities assume a duty to adequately and reliably serve all customers in their determined territories, and are required to have their rates and certain operations regulated."[2]

The Ontario Energy Board Act, 1998 (the "Act")

[1] [2006] 1 S.C.R. 140, para. 3.
[2] *Ibid*., para. 63.

The Board's powers to set rates for the sale, distribution and transmission of natural gas derive from section 36 of the Act. A distributor such as NRG can only charge for the distribution of gas pursuant to an order of the Board (section 36(1)), and the Board may make orders approving rates that are "just and reasonable" (section 36(2)). In approving just and reasonable rates, the Board may also adopt any method or technique that it considers appropriate (section 36(3)). Similarly, a section 36 order may include conditions, classifications or practices applicable to the sale, transmission, distribution or storage of gas, including rules respecting the calculation of rates (section 36(4)).

The Board's objectives for the natural gas sector under section 2 of the Act include: "To protect the interests of consumers with respect to prices and the reliability and quality of gas service."

The setting of just and reasonable rates is one of the Board's core powers. The courts have long recognized that the legislature intended that the Board have broad powers over rate setting. In *Natural Resource Gas v. Ontario Energy Board*, the court noted that the Board's power to set just and reasonable rates **"**is unconditioned by directed criteria and is broad; the board is expressly allowed to adopt any method it considers appropriate."[3] In *Advocacy Centre for Tenants-Ontario v. Ontario Energy Board*, the court stated that the Board should interpret its rate setting powers in a manner consistent with the objectives of the act, and in a fair, large and liberal manner.[4] The Court further observed: "The Court must apply a "pragmatic or functional" analysis in determining the issue of jurisdiction, by considering the wording of the *Act* conferring jurisdiction upon the Board, the purpose of the *Act* creating the Board, the reason for the Board's existence, the area of expertise of its members and the nature of the problem before the Board."[5]

The definition of "rate"

[3] [2005] O.J. 1520, para. 24.
[4] 2008 CanLII 23487, paras. 12, 55-56.
[5] *Ibid*., para. 14.

As discussed above, section 36 of the Act prevents a distributor from charging for the sale, distribution, transmission or storage of gas absent an order of the Board. The Board must ensure that the rates charged for any of these services are just and reasonable.

Section 3 of the Act defines a rate as: "a rate, charge or other consideration and includes a penalty for late payment." The definition, therefore, is quite broad. It is not limited simply to the fixed and variable rates typically included in a tariff, nor to the fixed charges that are routinely approved by the Board. In conjunction with section 36, it appears to encompass virtually any consideration paid by a customer to a utility.

III. Is a capital contribution a "rate"?

The chief question in the current proceeding is whether or not a capital contribution is a "rate" as defined by the Act. If a capital contribution is in fact a rate, there would seem to be little question that the Board has jurisdiction.

Based on the analysis above, the answer appears to be "yes". The definition of "rate" in the Act is very broad, and includes "other consideration". It appears to encompass virtually any required payment from a customer to a utility. The Board's powers over rate setting issues are very broad, which has been confirmed by the courts many times. In addition, one of the key purposes of regulation is to protect consumers from the exercise of monopoly power. IGPC's ethanol facility is located in NRG's service territory, and IGPC therefore has little choice with respect to its natural gas supplier. Under such circumstances, regulatory principles suggest that it is the Board's role to ensure that any payments required for the provision of distribution service are reasonable.

A capital contribution is a payment that a utility requires from a customer to ensure that the costs of a capital project designed to serve that customer are not subsidized by

other ratepayers, or by the shareholder. However, the Board also has a role in ensuring that the party paying the capital contribution (which is, of course, also a customer and a rate payer) does not pay more than is necessary, which would not amount to a just and reasonable charge to the customer. The formula for determining the amount of a capital contribution was set by the Board in the E.B.O. 188 proceeding. (Essentially the same formula is codified on the electricity side through the Distribution System Code ("DSC") and the Transmission System Code ("TSC")). The actual amount of any capital contribution will of course vary depending on the circumstances, and for this reason the Board cannot include the actual payment amount in the tariff of rates and charges as it does for other rates and charges at the end of a typical rates proceeding. This does not mean, however, that the Board loses jurisdiction over capital contribution payments, in particular when there is a dispute between the parties.

In response to the Board's first question, therefore, Board staff submits that a capital contribution is in fact a rate, and the Board has jurisdiction over this issue.

IV. Next Steps

To the extent the Board agrees that it has jurisdiction over the proper amount of the capital contribution, it should establish a process for determining this amount.

The Board has significant experience with assessing the appropriateness of capital costs. In virtually every rates case the Board is asked to approve various capital expenditures that are closing to rate base, and for all of these the Board must assess the prudence of the expenditures to ensure that the resulting rates are just and reasonable. Although the Board is not typically asked to settle the specific amount of a capital contribution, this exercise need not be significantly different than the Board's ordinary process for determining capital costs. In the current case, the E.B.O. 188 formula itself does not appear to be in dispute. Instead, the disagreement turns on NRG's inclusion of certain claimed actual costs in the total cost of the pipeline. This is the type of dispute that could arise in any rates case, and the Board is well equipped to

make these types of determinations. Once the appropriate actual costs of the pipeline are determined, the proper amount of the capital contribution is essentially just a matter of math.

To be clear, Board staff is not necessarily suggesting that the Board's role will be to assess whether the terms of the PCRA have been followed in determining the total capital costs. The Board's jurisdiction is to set just and reasonable rates, and it is not bound by the terms of any contract. The terms of the PCRA may well serve as a guide in this analysis, but it is the Board's role to determine what in fact are the reasonable costs of the pipeline (and then apply the formula to determine the amount of the capital contribution). To the extent that the PCRA produces a result the Board does not agree with, then the Board should rely on its own judgment.

V. Additional Considerations

Order required for a rate

A finding by the Board that a capital contribution is a "rate" may give rise to additional issues in other cases. In accordance with section 36, a utility cannot charge a rate except where that rate is approved by an order of the Board. Although the Board has established the formula for determining a capital contribution in E.B.O. 188, E.B.O. 188 is not technically an order of the Board. As discussed above, it would not be possible to include a specific amount for a capital contribution in a utility's tariff of rates and charges, as the amount cannot be known until the details of a particular project come to light.

As a matter of practice, when a capital contribution is required the utility and the customer apply the E.B.O. 188 formula to determine the proper amount. In virtually all cases the parties are able to agree on the proper amount, and other than setting the formula the Board is not directly involved. In fact, as many of these connections are not connected to any particular proceeding before the Board, the Board may not even be directly aware of many of these payments (the current case being an exception, as the

capital contribution was discussed in the leave to construct application). It would also not be practical to require a utility to file an application for a "rate" every time a capital contribution is required, as capital contributions for customer connections happen with great regularity on both the gas and the electricity side.

There may also be other payments that utilities require from customers that are not directly referenced in the utility's tariff of rates and charges. On the electricity side, for example, bypass compensation payments are sometimes required where a customer builds new assets that bypass existing utility assets.. The formula for determining the appropriate amount of this payment is established in the TSC, and like a capital contribution the amount of the required payment will vary depending on the circumstances. No specific "rate" is approved by the Board through a rates proceeding.

To the extent this is an issue, there are a number of potential solutions. Section 36(3) of the Act allows the Board to adopt "any method or technique that it considers appropriate" in setting just and reasonable rates. Assuming the Board retained jurisdiction to settle disputes (and thereby prevent the exercise of monopoly power against a customer where the proper capital contribution cannot be agreed upon), the Board could treat its approved E.B.O. 188 formula as the "method or technique" for setting the rate.

On a going forward basis, the Board could also consider adding a notation to utilities' tariffs of rates and charges in future rates proceedings. In place of setting the specific amount for a capital contribution (which cannot be calculated in advance), the tariff could simply state something in the nature of: "Where required, [the Utility] shall calculate the amount of any capital contribution charge in accordance with the formula approved by the Board in E.B.O. 188. Any disputes over the appropriate amount of a capital contribution can be referred to the Board for resolution." Indeed, section 36(4) of the Act specifically allows the Board to include rules respecting the calculation of rates in an order.

Finally, the Board could consider formally codifying the capital contribution formula through a section 44 Rule. This would mirror the practice on the electricity side, where the capital contribution formula is codified in the DSC and TSC. (If it chooses to consider this approach in the future, the Board should be mindful of the legislative differences for the regulation of gas versus electricity. In particular, on the electricity side the Board can specify methods or techniques for determining a utility's rates as a condition of license, which it has essentially done for capital contributions and bypass compensation by requiring compliance with the DSC and TSC as a condition of license. Gas utilities are not licensed, and there are no similar legislative provisions on the gas side.)

Remedy before the court of Ontario

IGPC and NRG entered into a Pipeline Cost Recovery Agreement ("PCRA"). Amongst other things, the PCRA set out the details for determining the amount of the capital contribution (in a manner consistent with E.B.O. 188). Section 11.2 of the PCRA provided that "the courts of Ontario shall have exclusive jurisdiction to determine all disputes arising out of this agreement." Parties may argue in this proceeding that, since the PCRA specifically provides that any disputes will be heard by the courts of Ontario, the Board cannot itself determine the appropriate amount of the capital contribution.

In Board staff's view, however, the difficulty with section 11.2 of the PCRA is that it is likely unenforceable. Section 19(6) of the Act states: "the Board has exclusive jurisdiction in all cases and in respect of all matters in which jurisdiction is conferred on it by this or any other Act." Through section 36, the Board clearly has exclusive jurisdiction over the setting of rates. If the Board finds that a capital contribution is a rate, then it is also clear that it has exclusive jurisdiction over setting the amount of the capital contribution. The PCRA cannot override the provisions of the Act, and if a capital contribution is a rate then the courts have no jurisdiction to resolve this particular dispute.

- All of which is respectfully submitted. -