Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION ON SETTLEMENT PROPOSAL FILED ON NOVEMBER 13, 2015

Union Gas Limited 2017 Dawn Parkway Project
EB-2015-0200

November 20, 2015

Background

Union Gas Limited (Union) filed an application with the Ontario Energy Board (OEB) on June 30, 2015 seeking pre-approval of the recovery of the cost consequences associated with the installation of three new compressors and associated facilities on the Dawn-Parkway transmission system. The total estimated cost of the project is $622.5 million.

In Procedural Order No. 4 dated October 5, 2015, the OEB scheduled a two-day Settlement Conference starting on October 20, 2015, with the objective of reaching a settlement among the parties on the issues. Union filed a Settlement Proposal on November 13, 2015, reaching a settlement on all issues in the proceeding.

Union Settlement Proposal

OEB staff has reviewed the Settlement Proposal filed by Union in the context of Union's 2014-18 (Incentive Regulation Mechanism) IRM Framework, other applicable OEB policies, relevant OEB decisions, and the OEB's statutory obligations. OEB staff is of the view that the application and Settlement Proposal appropriately reflects Union's 2014-18 IRM Framework and adequately protects the public interest.

OEB staff supports the proposed Settlement Proposal on the following basis:

- The proposed facilities are needed and both facility and non-facility options were adequately addressed
- The bill impact analysis indicates a decrease in rates for in-franchise customers
- The recovery of cost consequences is in accordance with Union's 2014-2018 IRM Framework
- The cost allocation methodological change results in enhanced cost causality

OEB staff is also of the view that the accompanying explanation and rationale is adequate to support the Settlement Proposal.

OEB staff offers the following commentaries on the project economics and feasibility guidelines, and the proposed change in the cost allocation methodology.

Project Economics and Feasibility Guidelines

Union completed an analysis to assess the economic feasibility of the project in accordance with the OEB's recommendations from the E.B.O. 134 Report on System Expansion. Consistent with the feasibility guidelines, Union employed a three-stage analysis to assess the economic feasibility for the proposed facilities.

The results of the Stage 1 analysis indicate a cumulative net present value (NPV) of ($343.1) million and a profitability index (PI) of 0.43. The Project Economics have been evaluated over a 30-year period.

A PI of 0.43 at Stage 1 indicates that the revenues from the project are not sufficient to cover the costs over the considered period. OEB staff notes that projects that include new compression facilities usually have lower PIs. Compressors are expensive investments and are lumpy in nature. The pay-back periods for such investments are fairly long-term. Compressors can last for over forty years with support from manufacturers. Union's previous Dawn to Parkway expansion (Union 2016 Dawn to Parkway, EB-2014-0261) also included a new compressor, the PI of which was 0.38.

Companies usually increase capacity by building pipelines. However, on occasions, they need to install additional compression to maximize the use of existing pipelines. The current project is one such initiative. OEB staff further note that the PI is negatively impacted by the fact that one of the compressors is a replacement compressor that does not add as much incremental capacity as the other two compressors.

Union did not complete a Stage 2 analysis that considers the estimated energy cost savings that accrue directly to Union's in-franchise general service rate customers as a result of using natural gas instead of another fuel to meet their energy requirements. The analysis was not provided because according to Union the proposed budget is based on the New Firm North Transportation Service rather than the incremental growth in energy demand using gas instead of alternative energy sources.

However, Union has provided a Stage 3 analysis that shows a positive NPV of $123 million. Since Union has followed the OEB's feasibility guidelines and because the resulting NPV is greater than zero at the third stage, OEB staff has no concerns.

OEB staff notes that in the Settlement Proposal, parties have requested that the OEB review the feasibility parameters in the E.B.O. 134 Report on the Economic Tests for Transmission Pipeline Applications. The parties noted the passage of time since E.B.O. 134 and the rapid evolution of both the market and gas infrastructure. The Settlement Proposal indicates that a number of the parties believe that a different approach to addressing feasibility and impact on existing ratepayers may be appropriate in the future, and that review and clarification by the OEB of feasibility parameters for future expansion projects would be timely. The parties also submitted that future expansion applications should include comprehensive evaluation of non-facility alternatives including temporary or permanent commercial alternatives. Parties further suggested that, to start with, the topic could be usefully included in the OEB's next Energy Sector Forum.

OEB staff notes that acceptance of the Settlement Proposal by the OEB does not commit it to reviewing E.B.O. 134 or including this topic as part of the OEB's next Energy Sector Forum. It is, however, a helpful suggestion that the OEB should take into consideration.

Cost Allocation

The parties agreed to make one change in cost allocation as a result of this project. The parties agreed to change the 2013 OEB-approved horsepower allocator at Dawn from an allocation on 55:45 (storage/transmission) to 64:36 with rates effective January 1, 2018. The re-allocation was based on the fact that the replacement compressor (Dawn H) will be providing only transmission services and not some storage services as the previous compressor and therefore all Dawn H costs are proposed to be directly assigned to transmission. Although cost allocation changes are not generally permitted during an IRM period, OEB staff agrees with the re-allocation as this reflects the actual usage of the assets and therefore results in enhanced cost causality. .

Appendix 2 of the Settlement Proposal provides the cost allocation related to the 2017 Dawn Parkway Project. As can be seen from the table, a majority of the project costs are allocated to ex-franchise customers. In fact, in-franchise rate classes will see a rate reduction as a result of the shift in indirect costs and the allocation of project property and income taxes.

An average residential customer in Union South will see an annual decrease of $6.83 while customers in Union North will see a decrease of approximately 8.83 per year.

Recovery of Cost Consequences

In its application, Union applied for the recovery of the revenue requirement in accordance with the IRM framework approved by the OEB in EB-2013-0202. The OEB in the 2014-2018 IRM Framework proceeding (EB-2013-0202) established a set of eight criteria for approving capital pass-through eligibility and allow recovery of the cost consequences of a capital project during an IRM term. In the Settlement Proposal, the parties agreed that the 2017 Dawn Parkway Expansion Project meets the capital pass-through mechanism approved by the OEB.

Union has provided the eight criteria[1] in the Settlement Proposal and has provided an explanation of how the current project meets the different criteria. OEB staff note that the project meets the threshold set by the OEB in EB-2013-0202 and have no concerns regarding pre-approval of the recovery of the cost consequences of the proposed facilities.

2017 Dawn Parkway System Expansion Deferral Account

The parties agreed to the establishment of the 2017 Dawn Parkway System Expansion Deferral Account. The account will capture the difference between the forecast annual net revenue requirement included in rates and the actual net delivery revenue requirement for each year of the IRM. As part of the settlement, Union agreed to include in the deferral account a credit of $1.34 million related to 30,393 GJ/day of surplus capacity created by the project that has not been contracted for. Variances in the actual revenue generated from the surplus capacity will also be recorded in the deferral account and will be adjusted against the $1.34 million credit.

Union has included the draft accounting order as part of the application but did not include it for approval in the Settlement Proposal. OEB staff is also not certain if the $1.34 million credit alters the filed accounting order in any way. The Settlement Proposal does not provide any clarification in this regard.

If the OEB were to accept the Settlement Proposal, then an additional process would be required to approve the accounting order. OEB staff submits that Union could perhaps file a revised Settlement Proposal that includes the draft accounting order and provide the required clarification with respect to the $1.34 million credit. This would expedite the process and eliminate an additional step.

– All of which is respectfully submitted –

[1] Union Gas Limited Settlement Proposal EB-2015-0200, Pages 21-23, November 13, 2015