

ONTARIO ENERGY BOARD STAFF
COMMENTS ON DRAFT ISSUES LIST
EB-2016-0004

Background

The purpose of this document is to assist parties, particularly those that are new to this generic proceeding and are not familiar with Ontario Energy Board (OEB) processes, to provide some background and articulate some of the broad issues that the OEB intends to hear in this proceeding. OEB staff also proposes that an additional issue related to the Ontario Government's recently announced cap and trade program be added to the draft Issues List.

In the Ontario Government's 2013 Long-Term Energy Plan, the Government stated that it would look at opportunities to expand natural gas service within the Province to areas that are not currently served. On February 17, 2015, the Ontario Minister of Energy in a letter to the Chair of the OEB encouraged the OEB to examine opportunities to facilitate access to natural gas services to more communities. On February 18, 2015, the OEB issued a letter stating that it will hear requests for regulatory flexibility or appropriate exemptions in the context of an application made for approvals pertaining to expansion projects. The OEB invited parties with the appropriate technical and financial expertise to propose, within their application, any options to address these regulatory issues.

In response to the letter, Union Gas Limited (Union) filed an application (EB-2015-0179) in July 2015 with the OEB seeking approval to provide natural gas service to certain communities that do not have access to natural gas. In that application, Union proposed alternative approaches to recover revenues in order to meet the investment needs to expand natural gas service to certain communities in Ontario.

Union's application proposed the following framework to recover costs related to providing natural gas to specific communities identified in its application:

- A Temporary Expansion Surcharge rate to collect contributions from customers attached in the new communities;
- An Incremental Tax Equivalent mechanism to collect contributions from municipalities of the new communities;
- An exemption from E.B.O. 188 guidelines that would allow individual community expansion projects to proceed at a Profitability Index of 0.4 or greater;

- An exemption of Community Expansion Projects from E.B.O. 188 Investment Portfolio and Rolling Project Portfolio requirements; and
- A capital pass-through mechanism to incorporate the community expansion projects in rates immediately following their in-service dates.

Union indicated that under its proposal, it could complete approximately 29 projects to provide natural gas service to 18,000 homes and businesses in 34 communities at an estimated cost of \$135 million.

The OEB determined that it would first address Union's proposed funding mechanism and deal with the specific leave to construct applications later in the context of the OEB's determinations on Union's proposed funding approaches.

The OEB held a Pre-Hearing Conference on December 18, 2015 where it heard from the parties that intended to file evidence and the specific issues that they intend to raise in the proceeding. Based on the submissions of parties, the OEB determined that the issues that were raised in Union's application were common to all gas distributors including new entrants that may apply to the OEB to provide gas distribution services in communities that do not have access to natural gas. The OEB therefore decided to establish a generic hearing on its own motion to deal with these common issues. The OEB decided to put Union's application on hold until the completion of the generic hearing. The OEB further determined that Union's application and evidence would form part of the record of the generic proceeding and all parties that were granted intervention status in Union's proceeding would be deemed as intervenors in the generic proceeding.

The OEB issued Procedural Order No. 1 on February 10, 2016 for the generic proceeding that established a process and timelines for parties to file evidence and discovery of that evidence. The OEB also issued a draft Issues List that captured the issues raised by the parties in Union's application and the issues that the OEB believed should be addressed in the application. The OEB has also invited comments on the draft Issues List by February 26, 2016.

Apart from proposing an additional issue, OEB staff has not proposed any changes to the existing draft Issues List. Rather, OEB staff has provided context to the issues and identified some of the external issues that are relevant to the proceeding.

Comments on Draft Issues List

One of the questions posed in the draft Issues List is whether the OEB has the legal authority to establish a framework whereby customers of one utility subsidize the expansion undertaken by another distributor. Epcor Utilities Inc. in its submission at the Pre-Hearing Conference of Union's application suggested that all qualified utilities (new and existing) should have access to a fund that is comprised of contributions from existing natural gas customers. The question is whether the OEB has the legal authority to create such a fund. However, OEB staff believes that, whatever the determination on this issue, it will not preclude existing utilities like Union and Enbridge Gas Distribution Inc. to recover the costs of expanding into new communities from existing customers.

Union in its application proposed certain flexibility to the OEB's existing gas expansion guidelines established in 1988 (the E.B.O. 188). The OEB in the generic proceeding will consider the type of flexibility that is required in the guidelines and the parameters that need to be established for community expansion projects.

In 1998, the OEB issued its report that provided guidelines for assessing and reporting on natural gas system expansion (E.B.O. 188)¹. The key metric used to assess projects was the Profitability Index or benefits to cost ratio. A Profitability Index of one means that existing customers are not negatively impacted from the cost of new connections and the recovery of revenues from rates for a given number of years fully recovers the cost of the project. This prevents the subsidization of new projects by existing customers.

A key finding of the OEB was to direct the utilities to use a portfolio approach to assessing the Profitability Index rather than assessing projects on an individual basis. The OEB determined that all projects must achieve a minimum threshold Profitability Index of 0.8 for inclusion in a utility's Investment Portfolio and an average rolling portfolio Profitability Index of 1.0 to ensure that existing customers will not suffer a rate increase over the long term as a result of distribution system expansion. The OEB also noted in that proceeding that the portfolio approach would prevent the need for the intense scrutiny of the financial viability of each project, would ensure that existing customers are not negatively impacted by new projects and the approach would assist communities to obtain gas service where it is not financially feasible on a stand-alone basis.

¹ Final Report of the Board and the Ontario Energy Board Guidelines for Assessing and Reporting on Natural Gas System Expansion in Ontario (E.B.O. 188), January 30, 1998

OEB Staff notes that if the OEB were to determine that some flexibility in the E.B.O. 188 guidelines is required, it would result in a decrease to the minimum threshold Profitability Index. This is because projects that meet the minimum threshold are assumed to have already been completed by the utilities and the only reason that an alternative framework is required is because some communities cannot be viably served under the current framework. A lower threshold Profitability Index would also mean that existing customers of a utility are paying a portion of the costs for expanding into the communities for new customers.

In a letter dated September 25, 2014, the Honourable Premier of Ontario, Kathleen Wynne informed the Minister of Energy that the government had established a \$200 million Natural Gas Access Loan program to help communities partner with utilities to extend access to natural gas supplies. An additional \$30 million Natural Gas Economic Development Grant was established to accelerate projects with clear economic development potential.

However, it is not clear whether the funds will be available in conjunction with any alternative approaches that the OEB may establish to fund expansion into the communities that do not have access to natural gas. Until the criteria under which the government proposes to distribute the funds is available, it is difficult for the OEB to take these funds into account in developing a framework. The funds may assist those that will proceed with gas expansion under the OEB's new framework.

Union in its application proposed a temporary surcharge rate from customers attached in the new communities. In other words, new customers in the specific communities would pay additional rates for a specific period in order to recover a portion of the costs to expand into the new communities. Similarly, Union proposed a contribution from the municipalities of the new communities. The property taxes payable on the gas distribution infrastructure would be rebated back to Union to fund the expansion costs.

The OEB in the generic proceeding intends to consider such measures to recover a portion of the costs of expanding into the communities. The OEB would need to also consider the quantum of such charges and the duration of these surcharges. Apart from these measures, the OEB intends to hear about other alternative ratemaking or rate recovery approaches that it should consider in establishing an alternative framework. Such measures could include an upfront contribution from new customers and/or temporary surcharges from new customers. Whatever measures are adopted by the OEB, it would have to be mindful of the fact that additional contributions or surcharges would impact the uptake of new natural gas service and would reduce the savings potential compared to other alternative fuels.

When a utility seeks to enter into a new municipality, it has to enter into a franchise agreement with the municipality in order to gain access to the municipal area. The franchise agreement is generally for a period of 20 years and has to be approved by the OEB. The utility also requires a Certificate of Public Convenience and Necessity from the OEB which grants the utility a quasi-exclusive right to supply gas and expand gas distribution services within a specific service territory. An issue may arise if a utility does not build the infrastructure to provide natural gas distribution services in a service area after being granted a municipal franchise agreement and a certificate. The OEB in this proceeding may wish to review if any additional conditions are required in order to ensure the development of the required natural gas infrastructure.

Staff Proposed Issue – Cap and Trade

On February 24, 2016, the Ontario Government introduced a new legislation on climate change. The proposed *Climate Change Mitigation and Low Carbon Economy Act* builds on Ontario's recent actions to fight climate change, working with industry and other partners on the design of a cap and trade program, releasing a climate change strategy and investing in projects that fight climate change through the \$325 million Green Investment Fund. The cap will put a limit on the amount of greenhouse gases that businesses, institutions and households can emit. The objective of the cap and trade program is to cut greenhouse gas emissions in the province and encourage the development of clean technologies.

OEB staff expects that the introduction of a cap and trade program could have significant implications on the natural gas sector. Natural gas utilities may be significantly impacted by the new regulations and may need to incur additional costs to implement the cap and trade program. Utilities will seek to recover the additional cost of implementing the program from its customers. The demand for natural gas may also decline over time as utilities, businesses and homes implement clean technologies. These pressures are expected to increase the cost of natural gas. As a result, the program could change the dynamics and cost considerations of any alternative framework that the OEB may establish in this proceeding. For instance, once the cap and trade program is implemented, natural gas may be a better alternative in terms of cost and reduction of greenhouse gases when compared to diesel or other heavy fuels while it may not be as competitive as it currently is when compared to electricity. This is because electricity generation in the Province has significantly reduced its carbon footprint since 2014 when Ontario phased out coal-fired power generation. However, it

should be noted that the cap and trade program will also affect all energy sources that contribute to greenhouse gases, not just natural gas.

OEB staff notes that the draft Issues List should include the Government's proposed cap and trade program and how it may impact the OEB proceeding. OEB staff therefore proposes the addition of the following issues to address this gap.

- How will the Ontario Government's proposed cap and trade program impact an alternative framework that the Ontario Energy Board may establish to facilitate the provision of natural gas services in communities that do not currently have access?
- What is the impact of the Ontario Government's proposed cap and trade program on the estimated savings to switch from other alternative fuels to natural gas and the resulting impact on conversion rates?

Role of Municipalities in the Generic Proceeding

The OEB published a notice informing the public at large about the generic proceeding and the issues that it would address and the approach it was contemplating in reviewing the proceeding. The notice was published in newspapers across Ontario and the notice was served on municipalities within Union's and Enbridge's franchise areas and the 103 municipalities identified in Union's application as well as First Nations.

Many municipalities have filed letters supporting the OEB's proposal to hear alternative approaches to provide gas distribution services in communities that are not currently being served. Some of the municipalities, especially those that were targeted for service by Union in its application, have expressed disappointment with the fact that the Union application has been put on hold while the generic hearing is being held. Staff believes that the proceeding would benefit from active participation of communities and customers in this generic proceeding. In addition, letters of comment on the approach to the expansion of natural gas are expected to be helpful to the OEB in determining the final framework to be used.

– All of which is respectfully submitted –