

Reply to the Attention of Laura Brazil
Direct Line 416.865.7814
Email Address Laura.Brazil@mcmillan.ca
Our File No. 231915
Date April 22, 2016

RESS

Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Attention: Kristen Walli
Board Secretary
boardsec@ontarioenergyboard.ca

Dear Ms. Walli:

**Re: CPA Responses to Interrogatories
EB-2016-0004**

We are counsel to the Canadian Propane Association (the “CPA”), an intervenor in this proceeding.

Enclosed are CPA’s responses to the interrogatories of Ontario Energy Board Staff in accordance with the Decision and Procedural Order No. 2, issued by the Board on March 9, 2016.

Yours truly,



Laura Brazil

/cs
Attach.
cc by email: Intervenors in EB-2016-0004

ONTARIO ENERGY BOARD

**Application under the Ontario Energy Board's own motion to consider
potential alternative approaches to recover costs of expanding natural
gas service to communities that are not currently served**

**CANADIAN PROPANE ASSOCIATION RESPONSES
TO INTERROGATORIES OF ONTARIO ENERGY BOARD STAFF**

**CANADIAN PROPANE ASSOCIATION (CPA) RESPONSES TO INTERROGATORIES
OF ONTARIO ENERGY BOARD (BOARD STAFF)**

Interrogatory 1

Reference

Evidence of Canadian Propane Association, Page 4

Preamble

The Canadian Propane Association (CPA) notes that in the EBO 188 proceedings, Ontario Energy Board staff warned that promoting general societal benefits and general economic development is beyond the Board's mandate. Board staff pointed out that it would not be effective, efficient or fair to tax existing ratepayers for general societal benefits and that economic development and the enforcement of social policy objectives is not the purpose of utility regulation. CPA claims that these principles remain true today.

In *Advocacy Centre for Tenants Ontario v. Ontario Energy Board* (238, O.A.C, 343), the Divisional Court allowed an appeal of the Ontario Energy Board's (OEB) decision that it had no jurisdiction to order a rate affordability assistance program under the *Ontario Energy Board Act*. The Divisional Court in its decision agreed that the OEB had the jurisdiction to establish a rate affordability assistance program for low income consumers purchasing the distribution of natural gas from the utility.

Please explain how the rate affordability assistance program is not similar to a social policy objective and is not a cost to existing ratepayers to subsidize a specific group of customers.

CPA Response

Advocacy Centre for Tenants Ontario v. Ontario Energy Board (238, O.A.C, 343) ("*Advocacy Centre*") suggests that the Board has no jurisdiction and no mandate to impose the subsidies proposed in this matter.

In *Advocacy Centre*, the issue was whether the Board had the jurisdiction to consider consumers' ability to pay when setting rates. The Divisional Court affirmed that the traditional approach of cost of service is the "root principle underlying the determination of rates" (para. 52). The Board is also authorized to consider the objectives set out in section 2 of the *Ontario Energy Board Act, 1998* when setting rates. In *Advocacy Centre*, the Court concluded that the Board has the jurisdiction to consider ability to pay in setting rates because it arises from the section 2 objective of protecting "the interests of consumers with respect to prices" (para. 55).

The Board's jurisdiction to consider ability to pay has no bearing on the jurisdiction questions in this matter, which are whether the Board can order the customers of a utility to subsidize rural and remote customers (i) of the same utility; or (ii) of another utility. Unlike *Advocacy Centre*, this proposal does not related to protecting "the interests of consumers with respect to prices" as there are no current customers in the proposed expansion areas. In fact, the proposed subsidies harm the interests customers who are forced to subsidize new customers.

CPA is not aware of any Board decision or other court or tribunal decision which states that the Board has the jurisdiction to make an order imposing the subsidies at issue in this proceeding. None of the objectives set out in section 2 of the *Ontario Energy Board Act, 1998* support a finding of jurisdiction.

Moreover, the Divisional Court in *Advocacy Centre* affirmed that it is beyond the Board's mandate to advance social policy objectives. The Court held that "the Board's mandate has not been directed to the public interest in social or distributive justice." Social policy should instead be addressed through provincial or federal government programs (para. 47). The Court emphasized that the Board "is an economic regulator, rather than a formulator of social policy" (para. 49).

The subsidies for rural and remote customers proposed in this matter *are* social policy objectives. Subsidies would be imposed not based on economic regulation principles, but on furthering the social policy of increasing consumers and businesses' energy choices. *Advocacy Centre* provides that it is beyond the Board's mandate to impose such subsidies. Instead, the social policy of increasing energy choices should be advanced through provincial or federal government programs, such as grants.

Interrogatory 2

Reference

Evidence of Canadian Propane Association, Page 5

The CPA argues that the OEB does not have the jurisdiction to order subsidization of natural gas service because it would both amount to a tax and (unlike for electricity) the *Ontario Energy Board Act* does not specifically give the OEB that power.

EBO 188 currently permits a modest level of cross-subsidy by allowing a Profitability Index (P.I.) of as low as 0.8 for specific projects, as long as a P.I. of at least 1.0 is achieved on a rolling portfolio basis. In the CPA's view is this cross-subsidy within the OEB's jurisdiction?

CPA Response

The “cross-subsidy” described by Board staff only applies to a rolling pool of new projects for which the aggregate P.I. is at least 1.0. There may be a number of projects within this pool, and there may be a number of customers within each project. But all of those customers are receiving some new service or some new benefit. It may be true that the P.I. of one such project might be 0.8 while the P.I. of another such project might be 1.2. But that does not alter the fact that all customers associated with those projects are receiving a benefit. Accordingly, all such customers are paying something and receiving some benefit. Does the size of the payment exactly match the size of the benefit? No, as that would be impossible to accurately determine and administer. But everyone associated with the projects receives a benefit and bears a cost.

Because the projects, taken together, have a total P.I. of at least 1.0, there is no need to impose an unrecoverable cost on customers who are not associated with these projects – i.e. customers who receive no benefit.

When the CPA discusses an impermissible subsidy, it is referring to a payment by a group who receives no benefit, to a group who receives the benefit.

Taken to the extreme local level, on a particular “Street X”, there may be 10 homes being connected to a new gas line. The first home, closest to the mainline, may in fact cost more to connect than the 10th home, furthest from the mainline. But both homeowners are receiving substantially the same benefit (connection to gas service), and both homeowners will pay substantially the same amount.

The CPA would not describe this as a “cross-subsidy”. It is just standard ratemaking. No one is paying who is not receiving a benefit.

If you now asked someone who does not reside on Street X and has no association with the new gas line down Street X, to also pay a fee that will never be returned, that would then be a permanent subsidy or a tax.

Bringing this back to the question at hand, if there is a pool of new projects with a P.I. of 1.0, every project within that pool is receiving the benefit, and every project within that pool is paying for the pool. No one is being asked to pay, on a permanent non-recoupable basis, if they are not participating in the benefit. So there is no cross-subsidy, where the P.I. is 1.0. Those who receive no benefit pay no cost.

Now, if the pool of new projects had a P.I. of 0.5, then there are four options:

1. Those who are receiving a benefit could pay more of the costs associated with that benefit, in order to bring the P.I. up to 1.0. If the benefitting customers are not supportive, they have a choice – they can choose not to connect and to continue procuring their energy from competing alternate sources at market or negotiated prices.
2. The government could provide a subsidy to those who receive the benefit, from the General Revenue Fund (tax funds which are collected for the very purpose of providing social benefits and reallocating wealth), in order to bring the P.I. up to 1.0. If taxpayers are not supportive, they have a choice – they can choose to change the government.
3. The utility could take responsibility for proceeding with a pool of unprofitable projects, in which case the P.I. remains at 0.5 and the utility's shareholders, who generally benefit from their investment in the utility, will see a slightly lower return because the utility invested in money-losing projects (which is the norm for every investor other than utility investors). If the shareholders are not supportive, they have a choice – they can choose to sell their shares and invest in something else.
4. The Board could impose a tax on unrelated customers who receive no benefit at all and have absolutely no power, in order to prevent benefitting customers, the utility that chose to do the project, or the taxpayers, from paying for these projects. If those unrelated customers are not supportive, there is nothing they can do.

Interrogatory 3

Reference

Ratemaking Principles and the Use of Subsidies in Natural Gas Community Expansion Program, Exhibit 3, Tab 3, Page 6

The report states that in the event the OEB authorizes cross-utility subsidization to occur, such that customers of one utility subsidize the expansion undertaken by another distributor, the OEB can mitigate some of the adverse impacts by removing the return on rate base component embedded in the subsidy so that there is only a return "of" and not "on" the capital investment associated with the expansion.

Please explain this approach in greater detail using an example.

CPA Response

The idea is that the expanding utility would not be able to earn a return on the subsidized component of its investment in system expansion. This has the effect of lowering the effective cost of the project to consumers, and particularly to unrelated, non-benefitting consumers.

Under the standard test for financial feasibility outlined in the EBO 188 Guidelines, assume that the PV of the capital associated with the portfolio of expansion projects is \$100M, the PV of the operating cash flow is \$80M, and the PV of the tax shield is \$0 (for simplicity). This implies a Profitability Index (PI) of 0.8 and a required subsidy of more than \$20M to achieve a PI greater than 1.0.

Assuming a 60/40 debt/equity ratio, the equity investment required for a \$100M capital project is \$40M. Assuming a 40-year asset life and a 9% after-tax return on equity, the expanding utility would collect approximately \$74M from customers in addition to depreciation and interest costs in order to earn its approved after-tax return on equity.

However, if the proposed approach were considered, instead of earning a return on the equity associated the full \$40M investment, the return on equity recovered through rates would be calculated as if the project cost \$80M and the required equity investment was \$32M. In this case the expanding utility would only collect approximately \$59M from customers in order to earn its approved after-tax return on equity.

Accordingly, on the \$80M portion, the expanding utility would recoup, from their own customers, the full \$80M plus a 9% return on the \$32M (40%) equity piece. On the remaining \$20M portion, the expanding utility would recoup, as a subsidy from their competitors' customers, the full \$20M but no additional return on the \$8M (40%) equity piece.

The expanding utility is thus incented to minimize the size of the subsidy it seeks from its competitors' customers. In the absence of this model, the expanding would be incented to push as much of the cost away from its own customer pool and on to the competitor's customer pool.

Interrogatory 4

Reference

Ratemaking Principles and the Use of Subsidies in Natural Gas Community Expansion Program, Exhibit 3, Tab 3, Page 6

In response to the question "what costs should be included in the economic assessment for providing natural gas service to communities and how are they to be determined and calculated?", Mr. Budd answers: "the economic assessment should allow for consideration of all or any quantifiable costs and benefits, including opportunity costs.

For example, there are potential unintended consequences and adverse impacts of expansion of natural gas to rural areas, such as adverse impacts on alternative fuel suppliers ... "

At a practical level, how would the OEB assess the impact of unintended consequences? How would these impacts be measured and quantified?

CPA Response

The impacts of unintended consequences considered in Stages 2 and 3 of the EBO 134 test are difficult to measure and quantify, and CPA does not propose any particular method for doing so. Accordingly, no weighting should be applied to the Stage 2 and Stage 3 analyses by the Board. The OEB should continue to use the EBO 188 test, which has clear and measurable inputs, among other benefits.

In the alternative that the Board does revert to a different test, all impacts of unintended consequences should be included. The measurement and quantification of those impacts will vary based on the type of impact.

In any event, the analysis described in Stage 2 and Stage 3 of the EBO 134 test, including an assessment of non-quantifiable consequences, would presumably be done by the Government in deciding how to allocate Natural Gas Access Loans, Natural Gas Economic Development Grants, or other government subsidy programs.

For a full explanation of the CPA's proposal for how to incorporate unintended consequences and other such factors, please see Exhibit S2.CPA.EnergyProbe.3(c) & (d).