EB-2016-0004

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act*, *1998*, S.O. 1998, c.15, Schedule B;

AND IN THE MATTER OF an 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

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CROSS-EXAMINATION COMPENDIUM OF THE SCHOOL ENERGY COALITION
(South Bruce Municipalities)

Jay Shepherd P.C.
2200 Yonge Street, Suite 1302
Toronto, Ontario M4S 2C6

Mark Rubenstein
Tel: 416-483-3300
Fax: 416-483-3305

Counsel to the School Energy Coalition

The Municipalities were very pleased about this new policy initiative as it signalled the importance to Ontario of expanding natural gas to unserved or underserved parts of the Province such as Southern Bruce.

Municipalities' Request for Information Process

The combination of the completion of the Business Case along with the new Ontario policy and financing aimed at promoting natural gas expansion led to the decision by the Municipalities to conduct a competitive RFI process to canvass the market for potential suppliers of natural gas distribution services. The primary purpose of the RFI concentrated on establishing the credentials of the respondents and their capacity to undertake the task of creating a natural gas distribution utility. The Municipalities' RFI package was sent to multiple utilities in both Canada and the United States on March 27, 2015.

The RFI contained the following description of the purpose underlying the Municipalities' competitive solicitation approach:

> Municipalities have initiated this RFI for the purpose of canvasing the Canadian and US energy sectors to gauge interest from potential investors and investment funds, publicly and privately owned utilities and regulated utility operators who may be interested in, and capable of establishing and operating, a natural gas distribution utility either in conjunction with the Municipalities or own their own (the "**Project**").
>
> At this time the Municipalities have made no decision on the preferred course of action or ownership structure. ***From the very beginning, the Municipalities' primary motivation has been, and remains, to bring natural gas to their communities to the benefit of their citizens, farms, businesses and industry*** *(emphasis added).* A new natural gas distribution utility could be owned entirety by the Municipalities as a newly created utility, it could be jointly owned with a public or private sector partner, or the new utility or new gas provider could be without any municipal ownership stake.

Accordingly, this RFI attempts to canvas the market to identify the scope and depth of potential qualified partners who may be interested in working with the Municipalities in achieving the Project.

Ideally, this RFI process will conclude with the Municipalities selecting one preferred proponent (the "**Preferred Partner**") to pursue the expansion of natural gas service into Southern Bruce. Thereafter, the Municipalities and Preferred Partner would determine the optimal option for implementing the Project which could be either of the Two Proposals[3] or potentially a different or varied approach. Thereafter, the required applications would be made to the Ontario Energy Board for the necessary approvals, pursuant to the OEB's Invitation Letter.

It is anticipated that the Municipalities would enter into Municipal Franchise Agreements with the Preferred Partner (or whatever legal entity is ultimately established to facilitate and implement the natural gas expansion). **[Insert Footnote Here]**

Among other things, the RFI obtained information from interested parties about their direct experience with respect to:

- system design and technical due diligence;
- financing;
- constructing;
- obtaining regulatory approvals and compliance;
- distribution rate design;
- natural gas storage; and
- owning and/or operating a regulated natural gas distribution utility.

As a result of its RFI process, the Municipalities received proposals from 6 different respondents.

[3] For example, a newly established Municipal-Preferred Partner jointly-owned utility could implement the UNION design or the Northern concept or pursue some other option yet to be identified.

After the Municipalities held meetings with all 6 proponents and after obtaining further information from proponents in a second phase of the RFI process, 4 finalist proponents were evaluated by the Municipalities.

In the end, the Municipalities selected EPCOR as their preferred proponent. The three Municipalities each approved and signed a Franchise Agreement with EPCOR on February 22, 2016.

Benefits of the Competitive Solicitation Process

While the process followed by the Municipalities was time consuming and costly, it had a number of important benefits which are summarized below.

1) Providing an opportunity for alternative approaches

Initially the Municipalities were constrained to information being provided by the only gas distributor in the region. The RFI process allowed other interested parties an opportunity to provide alternative views on meeting the region’s natural gas needs. The participants in the process brought different experiences and approaches to the resolution of problems and did so within the framework of a competitive process.

2) Understanding of the energy market in the region

Through the submissions of the participants the Municipalities improved their understanding of the size and composition of the potential market for natural gas in Southern Bruce. Related to this came more accurate estimates of the possibilities for savings in energy costs by various customer classes.

Equally important was the additional information provided on impediments to conversion to natural gas that could undermine project economics. Recommendations were also given on measures to overcome them.

3) System Design and Cost

The respondents to the RFI provided alternative approaches to system design and staging and the links between these elements and market development. In this competitive environment they also provided alternative views on capital cost estimates which resulted in a significant reduction from the initial estimates. All of these, of course, are critical to project viability.

4) Customer Rates Estimates

The estimated rates differed significantly between Union and the other participants in the process. In the Union study referred to above the utility was constrained to charge existing rates to new customers and to make up for the resulting non-economic nature of the project via a CIAC to be paid by the Municipalities. The other submitters viewed the project as stand-alone and determined the rates required to make it economically viable. This provided a better understanding of the scope for allocating expansion costs to those benefitting directly from the project via rates higher than current Union rates in the broader area.

5) Role of Subsidies

The information described above provided the Municipalities with a better understanding of the role that subsidies might play, whether originating with government programs or other consumers, and their potential magnitude. Different views were expressed on how any such subsidies would be used.

6) Ownership Options

Whereas the initial proposals for expansion were limited to two municipal ownership options, either none or all, the RFI process resulted in a range of ownership possibilities, including the gradual assumption of ownership over time. With the RFI process, the Municipalities could also individually decide on the preferred level of ownership individually after consideration of likely rewards and risks.

7) Regulatory Restrictions

The RFI process clarified the nature of the regulatory restrictions that impeded the expansion of natural gas markets. The major impediments in this regard included the combination of using current rates and a profitability index of 1.0 to determine a required contribution in aid of construction on the part of the municipalities. This proved to be an insurmountable hurdle. The stand-alone option provided more flexibility in the determination of rates which allowed consumers to realize energy cost savings while paying higher rates, at least initially, than surrounding communities. Union attempted to deal with this problem in its EB-2015-0179 application to the OEB via its proposed TES mechanism. Stand-alone rates, and possibly contributions over time by the municipalities, also raise the possibility of narrowing the size of any subsidy required to support the expansion of natural gas markets.

The process also pointed out the problem of the limitation of possible subsidization by other natural gas customers to current natural gas distributors, a restriction that would work against the entry of new participants in the market.

While all the proposals submitted were well considered the Municipalities concluded that EPCOR's proposal provided the best opportunity to work through these complicated issues jointly and finally bring natural gas service to the communities of Southern Bruce.

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South Bruce Interrogatory Responses

EXHIBIT S13

Exhibit R13.South Bruce.SEC.8

Reference: EB-2016-0137/138/139, Franchise Agreement, section 5

Interrogatory:

EPCOR has filed applications for approval of its Franchise Agreements with the Municipalities of Arran-Elderslie, Kinkarden (sic) and Huron-Kinloss. In each of those Franchise Agreements, EPCOR has agreed to pay each municipality an annual fee equivalent to 1% of the gross revenue derived by it for natural gas supplied for consumption within the municipality net of the commodity costs of supply. What role did the EPCOR's willingness to pay the annual fee have in their selection as the natural gas proponent for the South Bruce municipalities? Please describe the history and development of the annual fee.

Response:

EPCOR's proposed annual fee was only one of many factors considered by the Municipalities. The Municipalities understand that annual fees paid by gas utilities to municipalities are common practice in Western Canada. In the Ontario context, annual fees will help offset, over time, the municipal property tax rebate that has been requested by EPCOR to help support the economic viability of the gas expansion. The EPCOR franchise agreements were filed with the OEB for approval pursuant to Section 8 of the *Municipal Franchises Act*. These agreements will be the subject of OEB review pursuant to this separate application. The existence and rationale for any annual fees are not relevant to the issues this Board panel is considering in this EB-2016-0004.

ENBRIDGE GAS DISTRIBUTION INC. (ENBRIDGE)
RESPONSES TO INTERROGATORIES OF SEC

INTERROGATORY #25

Does Enbridge currently, or has it ever, paid a fee or made payment(s) to a municipality which it has a Municipal Franchise Agreement with, for the purposes of providing compensation for or in recognition of, it permitting Enbridge to operate within its municipalities. If so, please provide details.

RESPONSE

Enbridge is not aware of ever having paid a fee or made payment(s) to a municipality which it has a Municipal Franchise Agreement with, for the purposes of providing compensation for or in recognition of, it permitting Enbridge to operate within its municipalities.

UNION GAS LIMITED

Answer to Interrogatory from
School Energy Coalition ("SEC")

Does Union currently, or has it ever, paid a fee or made payment(s) to a municipality which it has a Municipal Franchise Agreement with, for the purposes of provide compensation for or in recognition of, it permitting Union to operate within its municipalities. If so, please provide details.

Response:

No. Union is unaware of any situation where this has occurred at least since the development of Model Franchise Agreements, and it is not a condition in any existing Franchise Agreements.

“**Exhibit S4.EPCOR.SEC.12**

Reference: EB-2016-0137/138/139, Franchise Agreement, section 5

Request:

EPCOR has filed applications for approval of its Franchise Agreements with the Municipalities of Arran-Elderslie, Kincardine and Huron-Kinloss. In each of those Franchise Agreements, EPCOR has agreed to pay each municipality an annual fee equivalent to 1% of the gross revenue derived by it for natural gas supplied for consumption within the municipality net of the commodity costs of supply. Will EPCOR seek to recover that that annual free from ratepayers or will that be a shareholder expense?

Response:

See the response to Exhibit.S4.EPCOR.SEC.7. ”

Supplementary Response:

Previously EPCOR declined to answer this question for the reasons expressed. On further review, EPCOR believes this question is relevant to the generic hearing. The answer is that EPCOR intends to apply to the Board to recover the cost of the franchise fee in rates.

<u>South Bruce Interrogatory Responses</u>

<u>EXHIBIT S13</u>

Exhibit R13.South Bruce. Board Staff.8

Reference: Exhibit 1, Pages 34-35

<u>Interrogatory:</u>

A theme that is central to these developments and the Board's Issues List is a re-examination of the system expansion methodology currently used by the OEB-regulated natural gas distributors and, more fundamentally, an examination of the most efficient and effective means of extending natural gas service to unserved communities, particularly those that do not meet the current EBO 188 economic feasibility criteria.

The Issues List in this proceeding does not actually presuppose that any changes to EBO 188 will be made. Issue 4 states: "Should the OEB consider exemptions or changes to the EBO 188 guidelines for rural, remote and First Nation community expansion projects?"

Elenchus' Report examines "the most efficient and effective means of extending natural gas service to unserved communities, particularly those that do not meet the current EBO 188 economic feasibility criteria". Did Elenchus take it as a given that changes would be made to the existing framework? In other words, is the Elenchus' Report focussed on "how" the Board could adjust its processes to allow for more gas expansion, not "if" the Board should do so?

<u>Response:</u>

The Elenchus report addresses mechanisms that have been used to achieve the objective of expanding the availability of utility services (natural gas distribution, electricity transmission and telecommunications services) to make projects economic and/or utility services available at affordable prices. It demonstrates that a variety of approaches have been used, including implicit and explicit cross-subsidies, as well as government subsidies of service providers and/or customers. While the Elenchus report suggests that a wide range of options are available to address the issues being examined in this proceeding, it does not make recommendations as to whether or how the current EBO 188 economic feasibility criteria might be revised.

Mr. Todd notes that the Southern Bruce approach to system expansion by EPCOR to serve the Southern Bruce region would neither require nor preclude changes to the EBO 188 criteria.

South Bruce Interrogatory Responses

EXHIBIT S13

Exhibit R13.South Bruce.SEC.7

Reference: Bacon Report

Interrogatory:

Please explain how Mr. Bacon believes that the Rural Rate Assistance methodology can be adapted for community expansion. Please provide a sample calculation.

Response:

For discussion purposes only the following outlines illustrative steps that could be taken to implement the rural rate assistance methodology

Step 1: Periodically (i.e. a period determined by the OEB), determine the weighting average urban residential monthly bill for delivery for Enbridge Gas Distribution Inc ("Enbridge"), Natural Resource Gas Limited ("NRG") and Union Gas Limited ("Union"). For illustration purposes, assume average monthly consumption is 170 m^3

Distributor	Estimated Monthly Residential Delivery Bill for 170 m3 (A)	Estimated Number of Residential Customers (B)	(C) = (A) * (B)	Contributing % (D)
Enbridge Gas Distribution Inc	$35.09	1,850,000	$64,909,942	59.4%
Natural Resource Gas	$41.22	8,000	$329,784	0.3%

Limited				
Union Gas Limited	$35.21	1,250,000	$44,012,550	40.3%
Total		3,108,000	$109,252,276	100.0%
Weighted Average Urban Residential Monthly Delivery Bill = Total (C) / Total (B) = $109,252,276 / 3,108,000 = 35.15 per month				

Step 2: The OEB would determine the appropriate level of differential between rural and urban residential rates above which rural rate assistance would apply. For illustration purposes, assume rural rate differential is 20%.

Step 3: The entity providing natural gas delivery service to the rural community would submit a cost of service application to the OEB according to OEB prescribed filing requirements. Within that application the applicant would develop residential delivery rates before applying rural rate assistance. For illustration purposes, assume the proposed “gross” monthly residential delivery bill for the rural community would be $45.00 for a monthly consumption of 170 m^3

Step 4: The application would also determine the rural rate assistance amount. It is assumed there would be 4,000 residential customers in the rural community. The annual rural rate assistance would be the $45.00 minus $35.15, from above, adjusted for the rural rate differential of 20% times the number of residential customers times 12. This would be ($45.00 – (35.15 x 1.20 or $42.18)) x 4,000 x 12 or $135,360 which would provide funding to produce a “net” monthly residential delivery bill for the rural community of $42.18 which is slightly above the delivery bill for Natural Resource Gas Limited .

Step 5: After the review of the application by the OEB and other parties, the OEB would approve the cost of service, the appropriate rates and the level of rural rate assistance.

Step 6: The OEB would order Enbridge, NRG and Union to pay the entity providing natural gas delivery service to the rural community the portion of the rural rate assistance as per the contribution percentage shown in the table above. For rural rate assistance of $135,360, this would result in a contribution of $80,421 for Enbridge, $409 for NRG and $54,530 for Union. In turn, Enbridge, NRG and Union would be allowed to recover the assigned amount in their delivery rates. This would result in an annual cost per customer of 4.3 cents for Enbridge, 5.1 cents for NRG and 4.4 cents for Union.