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VIA COURIER, RESS and EMAIL

June 20, 2016

Ms. Kirsten Walli Board
Secretary Ontario
Energy Board
2300 Yonge Street
Suite 2700
Toronto, ON
M4P 1E4

**Re: Ontario Energy Board Generic Proceeding
Natural Gas Community Expansion
Board File No.: EB-2016-0004
Enbridge Gas Distribution – Argument-in-Chief**

Pursuant to the Board's Procedural Order No. 3, attached please find two copies of Enbridge Gas Distribution's Argument-in-Chief.

This submission was filed through the Board's Regulatory Electronic Submission System (RESS). Confirmation of filing is attached to this letter.

Please contact the undersigned if you have any questions.

Yours truly,

[original signed]

Lorraine Chiasson
Regulatory Coordinator

cc: All parties to 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

ENBRIDGE GAS DISTRIBUTION INC.
ARGUMENT IN CHIEF

Introduction

1. In Procedural Order No. 2 for this proceeding the Ontario Energy Board (the "Board") identified twelve issues that it sought to address in this case. Later, in Procedural Order No. 3, the Board requested that parties to this proceeding provide further submissions on additional questions that flowed from the evidence provided in the hearing.

2. These are the submissions of Enbridge Gas Distribution Inc. ("Enbridge" or the "Company") filed in accordance with Procedural Order No. 3. In these submissions Enbridge will respond to each of the issues identified by the Board and it will address how the proposal that it has brought forward answers many of the issues identified by the Board. For this purpose, Enbridge will follow the numbering of the issues used in the Board-approved Issues List attached as Schedule B to Procedural Order No. 2.

Issue 1: What is considered a community in the context of this proceeding?

3. *In its proposal, Enbridge has addressed this issue by providing an appropriate definition of a Community Expansion Project and also by putting forward a definition of a Small Main Extension Project.*

4. As set out in its evidence, Enbridge maintains that a Community Expansion Project should be defined as a natural gas system expansion project which will provide first time natural gas system access where a minimum of 50 potential customers in homes and businesses already exist. This definition would apply to a community for which the current EBO 188 feasibility guidelines permit a Profitability Index ("PI") of less than 1.0.

5. With respect to the inclusion of what the Company has referred to as Small Main Extension Projects the Company clarified its position in its response to Undertaking J3.6. In this response Enbridge indicated that the intention of including Small Main Extension Projects in its proposed Community Expansion Portfolio (the "CEP") is to provide the opportunity for single or small clusters of potential customers to elect for payment of the System Expansion Surcharge as an alternative to paying a one-time Contribution in Aid of Construction ("CIAC"). The Company proposed to modify the definition of a Small Main Extension Project to be:

> *"…all other forms of distribution expansion which provide first time natural gas system access to customers where fewer than 50 potential customers in homes and businesses already exist and where the Profitability Index for the Project (the "PI") is less than 1.0."*

<u>Issue 2</u>: Does the OEB have the legal authority to establish a framework whereby the consumers of one utility subsidize the expansion undertaken by another distributor into communities that do not have natural gas service?

6. *Enbridge submits that the root principle of the Board's jurisdiction to approve just and reasonable rates is cost of service, even when incentive rate-making methodologies are used, and the cost of service of one utility does not include costs of subsidizing activities of another utility.*

<u>Issue 3</u>: Based on a premise that the OEB has such legal authority, what are the merits of this approach? How should these contributions be treated for ratemaking purposes?

7. *Enbridge submits that, even if the Board did have jurisdiction to require customers of one utility to subsidize activities of another utility, there are a number of reasons why any such jurisdiction should not be exercised by the Board.*

8. Section 36 of the *Ontario Energy Board Act, 1998* says that the Board may make orders fixing or approving just and reasonable rates for the transmission, distribution and storage of gas and that, in doing so, the Board may adopt any method or technique that it considers appropriate.[1] The Ontario Divisional Court has made clear that, under the statutory provisions empowering the Board to adopt any method or technique in the fixing or approval of just and reasonable rates, the

[1] *Ontario Energy Board Act, 1998*, S.O. 1998, chapter 15, Schedule B, section 36.

"traditional approach" of cost of service continues to be the root principle.[2] According to the Divisional Court, a cost of service approach is necessary to meet the fundamental, core objective of balancing the interests of all consumers, and the natural monopoly, in rate-setting.[3]

9. The cost of service of a gas distributor does not include the costs of funding expansion of service by another distributor. Further, the Board has been given no jurisdiction under the governing legislation to make allocative decisions about how funds recovered in rates from customers of a gas distributor might be used to pay for activities of other entities or to advance the interests of communities that are not served by the distributor.

10. In contrast to the concept of cross-subsidization among utilities, there is no doubt that Enbridge's proposed community expansion framework is within the Board's jurisdiction. Enbridge's proposal can be implemented in a practical and effective manner without any uncertainty about the jurisdiction of the Board to approve it and without any amendment to the governing legislation.

11. Beyond the purely legal question, in almost all respects the concept embodied in Issue #2 ignores many of the fundamental tenets of rate making for regulated utilities and would dilute the economies of scale that have developed over long periods of time by the incumbent service providers. With respect to economies of scale, the concept has apparently been acknowledged by the Province as it relates to the electricity sector where actions have been recently taken to promote the consolidation of local electricity distribution companies.

12. Another consideration is that the Discounted Cash Flow ("DCF") analysis that is employed to test the economic feasibility of projects today is time limited. Under EBO 188 the PI test that is used is limited to either a twenty or forty year time horizon, based on customer type. The DCF analysis called for in the EBO 188 guidelines only captures forecast customer additions in the first ten years following the completion of a system expansion project. In the case of Enbridge the Company's feasibility analysis assumes that seventy-five percent of the existing potential customers switch to natural gas within this time. This limitation does not recognize that customers typically continue to be added after the initial ten years following the availability of natural gas as evidenced by the Company's current On-

[2] *Advocacy Centre for Tenants-Ontario et al v. Ontario Energy Board*, 2008 CanLII 23487, at paragraphs 52 and 58.
[3] *Ibid*.

Main market penetration of over 97%.[4] This criteria does not recognize the development potential within the project areas beyond this ten year time period as indicated by the higher than forecast customer additions in many community expansion projects[5].

13. In the event that the Board established a framework whereby the customers of one utility subsidize the expansion undertaken by another gas distributor, the evidence shows that over extended periods of time, these subsidies may have never been required (ref. Undertaking J3.11). Although not perfectly aligned the return of any subsidy amounts to those that originally provided them can be far better facilitated where the subsidy and its return are contained within the same entity.

14. This line of thought is supported by the evidence of London Economics International LCC ("LEI")

> *Unlike EPCOR's suggestion to allow new entrants access to Union's customer base, (effectively creating a cross-subsidy between an incumbent utility and new entrants or other existing suppliers) an internal cross-subsidy does not unduly burden one utility's ratepayers at the expense of another utility's costs and revenue requirements. While EPCOR's suggestion may be perceived as a viable funding mechanism, it is likely to exacerbate the known negative effects associated with cross-subsidies more broadly, including violating the cost causation principle (without accounting for the return of an entity), and increasing the administrative burdens as a result of having more than one entity associated with the subsidy. Finally, whereas with internal cross subsidization, any potential economies of scale associated with the delivery of expansion projects would ultimately be realized by the incumbent's customers, that is not the case if those customers are forced to subsidize a neighboring competitor.*
> (Ref. Union Gas Evidence EB-2016-0004, Schedule 1, page 3)

Issue 4: Should the OEB consider exemptions or changes to the EBO 188 guidelines for rural, remote and First Nation community expansion projects?

15. *Enbridge has brought forward a proposal based on exemptions or changes from the EBO guidelines that strikes a reasonable balance between addressing the interests of prospective customers in unserved communities and avoiding an undue burden on existing customers.*

[4] Transcript, Volume 1, page 151, lines 5 to 14.
[5] Undertaking J3.11.

16. The fourth issue raised by the Board seeks to identify potential exemptions or revisions to EBO 188 for rural and remote community expansion projects. The evidence of both Union Gas and Enbridge provides a measure of the estimated economic feasibility for the potential community expansion projects each Company has identified. In all cases none of these projects could go forward based solely on the current EBO 188 guidelines. No party to this proceeding has challenged this finding. Given this, it is readily apparent that there will be very limited prospects for these communities to receive gas distribution services without some exemptions or revisions to the EBO 188 guidelines.

17. In its Filing Guidelines on the Economic Tests for Transmission Pipeline Applications in EB-2012-0092 the Board stated:

> *"The Board continues to hold the opinion that it is appropriate for existing customers to subsidize, through higher rates, financially non-sustaining extensions that are in the overall public interest if the subsidy does not cause an undue burden on any individual, group or class."*

Enbridge's proposal in this proceeding is consistent with this statement. The test of appropriateness is the comparison of what are defined in EBO 134 to be Stage 2 and Stage 3 Benefits to the burden imposed by the project.

18. The Enbridge proposal outlines several changes that could be made to the existing EBO 188 Guidelines that would enable the Company to pursue community expansion projects that do not meet the Board's current minimum economic criteria. In the Company's view its proposal recognizes the importance of finding a reasonable balance between the interests of those individuals residing in these communities and not placing an undue burden on existing customers.

Issue 5: Should the OEB allow natural gas distributors to establish surcharges from customers of new communities to improve the feasibility of potential community expansion projects?

19. *Enbridge's proposed framework includes a surcharge from customers in new communities and the proposed surcharge should be approved so that customers who benefit from expansion will contribute to it at a level that does not make conversion to gas unattractive to them.*

20. Changes to the EBO 188 guidelines alone could enable Community Expansion Projects to proceed. However, if exemptions or changes to the EBO 188 guidelines were the only means of supporting these projects and were significant enough to allow the potential Community Expansion Projects identified by Enbridge to go forward, the full subsidy associated with such projects would be borne by existing customers. The Company's proposal calls for a surcharge that serves as an alternative to an upfront capital contribution that enables those served by Community Expansion Projects to contribute toward the cost of these projects beyond what would be recovered from them in base rates and also describes how this additional revenue can be applied to lessen the impact of community expansion projects on existing customers. The surcharge proposed by Enbridge avoids large initial contributions in aid of construction and requires those that benefit from the expansion to contribute towards it. Additionally, the proposed surcharge maintains a degree of savings for new community expansion customers to make conversion to gas attractive to them.

Issue 6: Are there any other ratemaking or rate recovery approaches that the OEB should consider?

21. *While there probably are other ratemaking or rate recovery approaches that could be considered, Enbridge's proposal is a practical, effective and balanced approach that supports expansion to new communities.*

22. Given the nature of the EBO 188 DCF feasibility test there are three fundamental ways to make a Community Expansion Project more feasible. The first is to reduce the capital cost of the project, which in the past has been typically done by means of contributions in aid of construction. The second is to enhance the net present value of the project's forecast revenue stream. Without adjusting one or both of these factors the other means of meeting a project's revenue shortfall is subsidization by existing customers. In answer to the Board's question, yes, there probably are other ratemaking or rate recovery approaches that could be employed, but they would all come back to making adjustments to one, two or all of these three fundamental attributes of the current feasibility test.

23. For example, overheads allocated to project capital cost could be reduced, customer attachment time horizons could be extended, or reduced discount rates could be employed. Enbridge submits that any new feasibility model should: 1) allow these projects to proceed, 2) retain enough benefit to encourage potential

customers to convert to gas, and 3) not place an undue burden upon existing customers. Enbridge maintains that it has brought forward a framework for the Board's consideration that accomplishes all three of these objectives.

Issue 7: Should the Board allow for the recovery of the revenue requirement associated with community expansion costs in rates that are outside the OEB approved incentive ratemaking framework prior to the end of any incentive regulation plan term?

24. *Enbridge's current Custom Incentive Rate-making plan does not allow for recovery of the costs of implementing its proposal to expand service to new communities and the Board should approve a mechanism to allow recovery of such costs prior to the end of the term of the plan.*

25. In its responses to S3.EGDI.BSTAFF.7 and S3.EGDI.BOMA.12 the Company confirmed that its current Custom Incentive rate plan does not provide for recovery of either the capital or operating costs associated with the potential community expansion projects referenced in its evidence. As such, the Company confirms its position that the Board should allow for the recovery of the revenue requirement associated with Community Expansion Projects that were not included in the Company's incentive rate model cost base when brought into service prior to the end of the current incentive regulation plan. Further, the Board should allow for the recovery of the associated revenue requirement in any ratemaking model that may be approved by the Board in the future.

Issue 8: Should the OEB consider imposing conditions or making changes to Municipal Franchise Agreements and Certificates of Public Convenience and Necessity to reduce barriers to natural gas expansion?

26. *Municipal Franchise Agreements and Certificates of Public Convenience and Necessity are not barriers to natural gas expansion and there is no need to consider changes to Franchises or Certificates.*

27. This issue seems to suggest, and parties such as EPCOR have suggested[6], EPCOR that the existing Ontario gas distribution utilities were executing franchise agreements with municipalities in the Province and then not acting on these agreements to provide gas service to the areas covered by these agreements, effectively preventing new parties from

[6] See EPCOR letter to the Board dated April 27, 2016, .pdf page 2.

entering the market for the provision of such services.[7] In its third procedural order in this proceeding the Board expanded on this question asking for input as to: *Should the Municipal Franchise Agreement approval process be accompanied by a selection process? Who should conduct such a process and what should the selection criteria be? How would the needs of large users be considered?* In general the Company believes that no changes are necessary to the process of reaching Franchise Agreements, attaining CPCNs or developing Model Franchise Agreements at this time. There are several reasons for this.

28. First, the evidence of the Company disproves EPCOR's contention that the Company has employed a practice of tying up segments of the market by entering into Franchise Agreements and then not acting on them to gain the required Certificates of Public Convenience and Necessity ("CPCN"). The response to S3.EGDI.EPCOR.1 demonstrates that the Company is providing gas service to customers in all municipalities where it has Franchise Agreements in place. Those municipalities identified in this interrogatory response without Enbridge customers are upper tier municipalities where the purpose of the Franchise Agreement is the provision of access to regional road right of ways for pipeline construction and maintenance.

29. Second, municipalities can and in some cases do have Franchise Agreements in place with both Enbridge and Union Gas. Franchise Agreements are not exclusive and there is nothing to prevent municipalities from entering into them with more than one gas distributor.

30. Third, it is the CPCN that enables a distributor to construct facilities in a municipality and serve its constituents not the Franchise Agreement. CPCNs are granted by the OEB approval and as such are reviewed by the regulator in conjunction with the related leave to construct applications where the technical, environmental and economic aspects of system expansion projects are considered.

31. Lastly, in the Company's view the Province's Municipal Franchises Act already provides the Board with the authority required to deny a franchise if it deems it appropriate to do so.

> ***"Application to Energy Board for renewal, etc., of gas franchise***
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> *10. (1) Where the term of a right referred to in clause 6 (1) (a), (b) or (c) that is related to gas or of a right to operate works for the distribution of gas has expired or will expire within one year, either the municipality or the party having the right may apply to the Ontario Energy Board for an order for a renewal of or an extension of the term of the right. R.S.O. 1990, c. M.55, s. 10 (1); 1998, c. 15, Sched. E, s. 21 (8).*

[7] Letter dated April 27, 2016 from EPCOR to the Board concerning incomplete interrogatory responses, point #2.

Powers of Energy Board

(2) The Ontario Energy Board has and may exercise jurisdiction and power necessary for the purposes of this section and, if public convenience and necessity appear to require it, may make an order renewing or extending the term of the right for such period of time and upon such terms and conditions as may be prescribed by the Board, or if public convenience and necessity do not appear to require a renewal or extension of the term of the right, may make an order refusing a renewal or extension of the right. R.S.O. 1990, c. M.55, s. 10 (2)." (Source; Municipal Franchises Act, R.S.O. 1990, CHAPTER M.55)

Issue 9: What types of processes could be implemented to facilitate the introduction of new entrants to provide service to communities that do not have access to natural gas? What are the merits of these approaches and what are the existing barriers to implementation?

32. *No action is required by the Board to further facilitate the introduction of new entrants to provide gas service to communities that do not now have access to natural gas.*

33. Municipalities are free to select a gas distributor of their choice and employ whatever type of selection process they deem fit subject to OEB approval of the Franchise Agreement(s) entered into by them. Franchise Agreements are not exclusive and municipalities are and can be served by more than one gas distribution company. CPCNs are time limited and if a franchise is not acted on within a reasonable period of time a municipality is free to enter into a Franchise Agreement with another gas distributor upon the expiry of a CPCN since the model Franchise Agreement does not grant exclusivity.

34. As articulated in Enbridge's evidence in this proceeding the Company is of the view that new entrants to the market for regulated natural gas distribution services should demonstrate that they can meet all of the Province's requirements for a gas distributor as articulated at pages 27 to 30 of the evidence of Union Gas and beyond this demonstrate that they will provide economic benefits to Ontario beyond that provided by incumbent service providers. (Exhibit S3.EGDI.BOMA.15).

35. With respect to the awarding of Franchise Agreements EPCOR's witness Dr. Yatchew acknowledged that this would probably occur before a winning proponent even knows what its rates would be.

"MR. STEVENS: Thank you, Mr. Chair. Good afternoon, Dr. Yatchew. My name is David Stevens, and I'm here on behalf of Enbridge Gas Distribution. I see I have 15 minutes today, so I'll move as quickly as I can.

Starting in your pre-filed evidence at pages 6 to 7, you speak about the benefits of competitiveness or competition for franchise areas, and one of the items that you note is that this is likely to ensure that new customers are served at the lowest cost.

Given that observation, would you agree that the anticipated rates that a distributor will charge to customers in the new community is a relevant item, that should be disclosed to and considered by the municipality when it's considering competing bids?

DR. YATCHEW: I'm not certain at what stage that information would reasonably be disclosed with some -- reasonably available with some confidence to the municipality.

For example, if there's a multi-stage process, as we have here, a franchise agreement stage and a subsequent leave to construct, it is not clear to me at what stage. But eventually, yes. Before we start digging, or somebody starts digging, the municipality should have some idea of what kind of rates to anticipate.

That is also an essential part of the assessment of rates of conversion --version within the -- within that municipality.

So, yes, at some point in the process." (transcript, Vol. 7, page 8 – 9)

36. One wonders how a municipality can make an informed and intelligent selection of a gas distributor to serve its constituents without even knowing what the winning project proponent would charge these customers for service. Or, for that matter how the winning project proponent could even provide a reliable a feasibility analysis if as Dr. Yatchew has stated an essential part of the assessment, the "rates of conversion", are unknown as a result of not knowing what the rates of the winning proponent would be. From this it seems that EPCOR's witness accepts that rates of conversion from alternate fuels to gas are more reliable when the cost of the gas service is known.

<u>Issue 10</u>: How will the Ontario Government's proposed cap and trade program impact an alternative framework that the OEB may establish to facilitate the provision of natural gas service in communities that do not currently have access?

37. *The recently released Climate Change Action Plan of the Ontario Government supports a mandate to provide natural gas service to rural communities (i.e. community expansion). This support for expanding natural gas service suggests that the Ontario Government does not see the cap and trade program will impact the OEB implementing adjustments to EBO 188 to facilitate expansion.*

Also, Enbridge will be working with the Ontario Government to see that natural gas is part of the Province's greenhouse gas solution and thus the cap and trade program should have little or no impact on the framework established by the Board to facilitate the provision of natural gas service to currently unserved communities.

Issue 11: 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?

38. *Under the proposed cap and trade plan, natural gas will maintain its price advantage over heating oil and propane which are both more carbon intensive than gas. In comparison to electricity using gas for space and water heating purposes is far more efficient than burning gas to generate electricity to be used for space and water heating purposes.*

39. As it is currently understood by Enbridge the Province's cap and trade program slated for implementation in 2017 is expected to have the effect of increasing the cost of all fossil fuels. Since natural gas is the least carbon intensive of fossil fuels its price advantage over heating oil and propane is expected to increase, making natural gas the most cost effective alternative to these fuels for the foreseeable future. During the hearing Enbridge pointed out that even when carbon is priced at a level of $200 per tonne natural gas retains a significant price advantage over other energy alternatives (Transcript Volume 3, page 75, and Exhibit J3.2). Exhibit J3.2 shows that natural gas will retain a 38% price advantage over its nearest competitor propane even with carbon priced at $200 per tonne.

40. Compared to electricity the estimation of future price differentials is less certain given the fact that as of March 2016 29% of Ontario's electricity generating capacity is fueled by natural gas making it the second largest contributor to Ontario's electricity supply mix.

> *"The role of natural gas generation in Ontario's supply mix has increased in recent years with the phase out of coal-fired generation. Natural gas has approximately 10,000 MW of installed capacity. It is often used to ensure a reliable power supply during higher demand times."* Further, this capacity is expected to grow. *"It is also the cleanest of the conventional fuel types, producing less than half of the emissions. Plans are underway to build two new natural gas generating stations in Napanee (900 MW) and Sarnia (300 MW)."* (Source IESO, http://www.ieso.ca/Pages/Ontario%27s-Power-System/Supply-Mix/default.aspx.)

41. Enbridge’s experience is that demand for natural gas for electricity generation increases when temperatures decline. When comparing the economics and carbon impacts of natural gas as a direct heating and water heating fuel, its role as a reliable electricity power supply during times of peak demand needs to be considered. From the standpoint of carbon emissions alone one needs to question the logic of replacing a 96% efficient gas furnace with 40% to 50% efficient gas fired grid electricity generation to fuel electric resistance heating and geothermal heat pump systems.

42. In its evidence the Company has made it clear that it will be working with the Province and other stakeholders to reduce the carbon footprint of natural gas thereby making it part of the Province’s greenhouse gas solution. Based on all of this Enbridge is of the view that natural gas will continue to be Ontario’s economical fuel choice for space heating, water heating and many other uses. The prospect of carbon pricing in coming years will have little impact on the potential for gas distribution Community Expansion Projects.

Issue 12: How should the OEB incorporate the Ontario Government’s recently announced loan and grant programs into the economic feasibility analysis?

43. *Grant funding can be used either to support additional community expansion beyond that achievable under the framework approved in this proceeding or to reduce rate impacts on existing customers of implementing the framework. Loan funding would best be directed to new customers in community expansion projects to defray their costs of converting to gas.*

44. The last of the twelve issues raised by the Board addressed the question of how it should incorporate the Ontario Government's loan and grant programs into the economic feasibility analysis. The Board also requested submissions on how to incorporate the loan and grant programs into the economic feasibility analysis and how the disbursement of these funds might relate to the OEB’s approval of expansions.

45. The community expansion proposal that Enbridge has brought to the Board for consideration was designed such that it could be successfully implemented without financial assistance from the Province. One of the main reasons for doing this was to maintain as much flexibility as possible in terms of how the Province’s loan and

grant program could be applied to support such projects given that the details of this program are unknown at this time.

46. With respect to grant funding the Company is of the view that the simplest and most effective means of applying this funding would be by using it as a contribution in aid of construction to reduce the capital cost of projects. By doing this the economic feasibility of the projects would be enhanced, the result being that either more projects could be undertaken or the rate impact on existing utility customers would be reduced.

47. The treatment of funding provided by way of loans provided by the Province is more complicated as the Company assumes that these loans will ultimately need to be paid back. If these monies were loaned to the municipality and then used a capital contributions in aid of construction and the municipality was to pay them back to the Province the constituents of the municipality many of which would become customers would presumably end up paying this money back through property taxes or other municipal levis. If the monies were loaned to the gas utility they would need to be somehow recovered in gas rates or surcharges paid by those served by the community expansion projects and again be repaid to the Province.

48. Given that the loan funding would ultimately need to be paid back, Enbridge is of the view that the best solution would be for the loan funding to be directed to the new customers in the community expansion projects to defray the cost of converting their heating and water heating systems to natural gas. By doing this the upfront cost to those served by community expansion projects to convert to natural gas is reduced which should increase and accelerate customer capture thereby improving the financial performance of these projects.

Conclusion

49. As stated in the Company's pre-filed evidence in this proceeding, it has presented the Board with an innovative proposal for a framework that addresses the issues identified in the EB-2016-0004 issues list. The Company's proposal strikes a reasonable balance between the interests of existing customers and those potential customers located in remote communities.