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BY EMAIL and RESS

June 20, 2016
Our File: EB20160004

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

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2016-0004 – Natural Gas Community Expansion – SEC Final Argument

We are counsel to the School Energy Coalition ("SEC"). Pursuant to Procedural Order No. 3, please find the Final Argument of SEC.

Yours very truly,
Jay Shepherd P.C.

Mark Rubenstein

cc: Wayne McNally, SEC (by email)
All parties (by email)

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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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FINAL ARGUMENT
OF THE
SCHOOL ENERGY COALITION

June 20, 2016

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1 OVERVIEW

1.1 Introduction

1.1.1 This proceeding was initiated by the Ontario Energy Board (the "OEB" or "Board") to consider generic issues that were raised during the Union Gas Ltd. ("Union") application (EB-2015-0179), and were common to all natural gas distributors in the province, and any new entrants that wish to expand natural gas service.[1] Union had brought its application in response to the Board's letter dated February 18, 2015, inviting applications which may require regulatory flexibility to expand natural gas distribution services to existing rural, remote, and First Nations communities (referred to broadly in these submissions as "unserved communities").

1.1.2 This is the Final Argument of the School Energy Coalition ("SEC").

1.1.3 SEC has not strictly followed the structure of the Board's Issues List[2] in these submissions as many of the issues raised during this proceeding are interrelated and do fall easily within just one issue. To help the Board, at Appendix A we have provided table cross-referencing the Issues List and these submissions.

1.2 Background

1.2.1 The Board in this proceeding has tasked itself with creating a possible framework to allow for the expansion of natural gas service in Ontario to unserved communities[3], which currently would not meet the requirements set out in the current distribution expansion guidelines determined in EBO 188.[4] Under the economic feasibility assessments set out in EBO 188, expansion to these unserved communities would be uneconomic.

1.2.2 The intent of EBO 188 was to create a set of distribution expansion guidelines which

[1] *Procedural Order No. 1*
[2] *Decision and Procedural Order No.2*, Schedule B: Issues List
[3] *Procedural Order No. 2*; Tr.1, p.93; Tr.1, p.151; Tr.3, p.126
[4] *Final Report of the* Board (EBO 188), January 30 1998 ["*EBO 188*"]. The Report in Appendix B, also established the *Guidelines for Assessing and Reporting on Natural Gas Distribution System Expansion in Ontario*

balance providing a way for utilities bring natural gas service to new communities, while minimizing cross-subsidization over the long-term between new and existing customers. If the Board is to alter the balance struck in EBO 188, which may be appropriate, it still must be in done in furtherance of the Board's statutory objectives for natural gas under the *Ontario Energy Board Act, 1998* ("*OEB Act*"), which include "to facilitate the rational expansion of transmission and distribution system".[5]

1.2.3 At a fundamental level, uneconomic expansion is not rational expansion.[6] Therefore the Board must ensure that if it makes any changes to the guidelines, it still leads to expansions that are economic. This is exactly what the Minister had in mind in his letter to the Board when he specifically referenced the Board's support for rational expansion using the same wording as set out in in the *OEB Act.*[7]

1.2.4 If the Board makes any changes, it must balance any expansion to new customers, with protecting existing customers. It must also ensure the system as whole is considered not just in the short-term but also in the long-term. This is more critical than ever as the natural gas system is about to undergo fundamental changes. Ontario has begun a path towards a greenhouse gas emissions ("GHG") free economy[8] with the enactment of the *Climate Change Mitigation and Low-carbon Economy Act*.[9] This Act, and the accompanying regulations[10], have set up a cap and trade program which will begin next year, and require dramatic reductions in GHG emissions over the next 35 years, with a significant portion of that having to come from natural gas.[11] The Government has also

[5] *Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Sched. B* ["*OEB Act*"], s.2(3)
[6] OEB Act, s.2(3)
[7] EB-2015-0179, Ex. A-1-Appendix, p.1, Letter from the Minister of Energy to the Chair of the Ontario Energy Board, dated Feb 17 2015:

> I am writing to you today to encourage the Board to continue to move forward on a timely basis on its plans to examine opportunities to facilitate access to natural gas services to more communities, and to reiterate the government's commitment to that objective. I appreciate your counted support to ensure the rational expansion of the natural gas transmission and distribution system for all Ontarians. [emphasis added]

[8] *Climate Change Mitigation and Low-carbon Economy Act*, SO 2016, c 7, Preamble:

> Enabled and supported by the cap and trade program and related actions, the Government of Ontario envisions, by 2050, a thriving society generating fewer or zero greenhouse gas emissions.

[9] *Climate Change Mitigation and Low-carbon Economy Act*, SO 2016, c 7
[10] *The Cap and Trade Program*, O Reg 144/16
[11] S3.EGDI.ED.6, Attachment,p.15

recently announced the Climate Action Plan which involves directing significant resources collected from the cap and trade program to a wide-range of programs intended on reducing GHG demand.[12] The risk of stranded assets is high, as on one hand this proceeding seeks to expand the natural gas system, while at the same time there is significant legal and policy framework in place to promote reductions in GHG's emitting fuels such as natural gas.

1.2.5 SEC has member schools on both sides of the equation in this matter and its submission reflects that balance. There are many schools that are currently unserved by natural gas, and some schools that would be served by the proposed expansion projects of both Union and Enbridge Gas Distribution Inc. ("Enbridge"). Most of those schools want to be connected to the natural gas system. At the same time, a majority of the schools are already served by natural gas, and have an interest in ensuring that they do not have to pay for expansions which will not be able to pay for themselves over the long run.

1.3 Summary of Position

1.3.1 SEC does not oppose making *some* changes to EBO 188, or granting exemptions from it, for the purpose of expanding natural gas service to unserved communities. SEC recognizes that natural gas in some cases provides for a much cheaper source of heating today, and for businesses it may be a necessary energy input to their production. Moreover, the history of much of the natural gas expansion in the 1980s in Ontario was made possible in part because of the subsidies provided through the Federal Government's Distribution System Expansion Program that made the projects economically viable.[13] In that case, however, it was taxpayers not ratepayers who provided that funding.

1.3.2 The proposals by Enbridge and Union are not appropriate. They do not create a proper balance between allowing for a policy that allows natural gas expansion to unserved

[12] Government of Ontario, *Climate Action Plan*, http://www.applications.ene.gov.on.ca/ccap/products/CCAP_ENGLISH.pdf ["*Climate Action Plan*"]
[13] John Todd (Elenchus Research Associates Inc.), *Mechanisms for Supporting Natural Gas Community Expansion Projects, March 21 2016,* p.4-6 *(*Evidence of the Municipality of Kincardine Municipality of Arran-Elderslie Township of Huron-Kinloss)

communities, while protecting existing customers. Their proposals do not ensure that these new customers pay their fair share for access to natural gas which almost exclusively benefits them, while ensuring that the undue costs and risks are not being borne by existing customers. Their proposed changes are not rational expansion of the distribution system. They do not recognize the huge benefits that the utilities themselves are reaping from being able to expand the natural gas system, while bearing no incremental risk themselves. The combined proposals of Enbridge and Union seek to spend $545M in capital costs[14], to provide service to only 25,353 customers[15]. In addition more than half the costs over the life of those assets will be paid by existing customers. Under Enbridge's proposal, its existing customers alone would be required to contribute $439.22M over the next 40 years to fund these expansions.[16]

1.3.3 SEC submits that limited expansions to unserved communities should be allowed, if the following conditions discussed in detail in these submissions are met:

i. The aggregate amount of expansion must be limited to a reasonable amount to ensure the absolute level of impacts on existing customer rate, but also the level of cross-subsidization required per project is reasonable;

ii. Each proposed project must demonstrate that natural gas expansion is the most cost-effective way from the perspective of the system (i.e. the subsidized cost) to achieve the stated goals of lower energy bills to potential customers;

iii. While it may not be the entire cost, new customers and communities must pay their fair share of the expansion;

iv. Any cross-subsidy from existing to new customers is not done at the expense of potential entrance of new utilities who seek to provide service to unserved communities at lower costs. The Board should promote competition for utilities to bring service to unserved communities and subsidies provided on a jurisdiction-wide basis; and

v. The framework is universal and not utility specific. It must be able to be applied by Union, Enbridge, and any other regulated gas distributors that begin to operate in Ontario. Differing rules creates unfairness to both new and existing customers simply based on the utility that serves them.

[14] Enbridge is proposing to add $410M and Union at least $135M (S15.Union.VECC.2)
[15] Enbridge forecasts to add 16,256 customers, while Union forecasts to add 9,107 customers (S15.Union.VECC.2)
[16] S3.EGDI.SEC.22

1.3.4 As discussed through these submissions, one important aspect of any determination that the Board makes, and this permeates through most of SEC's argument in this proceeding, is that the proper assumptions and calculations are made when making an economic evaluation of any specific expansion projects. This is especially important since the economic feasibility calculations are being done on a 40-year discounted basis, where one can only compare actuals versus forecasts, after 40 years. High quality forecasts are critical to ensuring any expansion meets the objective of being rational.

1.3.5 Both the proposals of Enbridge and Union are premised on subsidies from existing customers to fund expansion to unserved communities. Both utilities take it as a given that to expand, the Board must provide for subsidies. No other means of regulatory mechanisms were even considered by the utilities.[17] At the same time they are taking no incremental risks[18] and stand to gain substantially by the significant increase in rate base. Neither utility would consider accepting a lower Return on Equity ("ROE") in return for being allowed to expand their combined rate base by over a half billion dollars for what is *currently* considered uneconomic, and thus imprudent expenditures.[19]

1.3.6 On top of this, the utilities are seeking to treat these expenditures as pass-through costs. As discussed later, SEC submits they are not eligible under the each of Enbridge or Union's respective incentive regulations ("IR") plans for such treatment. But regardless, it is incredulous that with such one sided benefits, the utilities are not willing to take on any forecast risk. Such an approach is not in accordance with the Board's move towards alignment of natural gas rate-setting approaches with the *Renewed Regulatory Framework for Electricity*[20] which involves demonstrating an ability to "manage with the rates set, given that actual costs and revenues will vary from forecast".[21] SEC submits the Board must require the utilities to take a risk commensurate to the benefit it will gain as a result of any framework the Board issues.

[17] S3.EGDI.SEC.1; EB-2015-0179 B.SEC.4; EB-2015-0179 , B.FRPO.1
[18] S3.EGDI.BOMA.13
[19] Tr.1, p.227; S15.Union.BOMA.89
[20] OEB Letter to All Rate Regulated Natural Gas Distributors Re: Filing Requirements for Natural Gas Distributor Rate Applications EB-2016-0033) March 7, 2016
[21] *Board Report*: *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach*, October 18 2012, p.19

1.3.7 The required conditions set out by SEC will ensure that any framework that results from this proceeding will lead to the Board having the ability to test, in any given proceeding, that any new framework that is developed will be in the public interest, and ensure its application will result in just and reasonable rates.

1.4 Board's Role

1.4.1 The foundation of this proceeding, and Union's EB-2015-0179 application, is the Board's letter to existing utilities in the province, and any new entrants that wish to expand natural gas service, dated February 18, 2015, inviting applications which may require regulatory flexibility to expand natural gas service to unserved communities. The Board's letter was to further the Ontario Government's policy, originally set out in the Long Term Energy Plan, to expand natural gas service in the province.[22] The Minister of Energy also had specifically written to the Chair of the Board, encouraging it to examine opportunities to facilitate natural gas expansion to unserved communities.[23] The Minister of Economic Development, Employment and Infrastructure has also announced that there will be grants and loans available to support this expansion policy. [24]

1.4.2 Through the proceeding, some parties have consistently stated that the Board should approve the proposals, or some variant, because they align with the Government's policy of expanding natural gas to unserved territories. For example, Mr. McGill on behalf of Enbridge said, "[in] order to achieve the province's objective of extending gas into these communities, it will be necessary to be exempted from some of the EBO 188 requirements, in our view."[25] Mr. Simpson on behalf of Union said with regards to their proposal, "[l]ooking on balance I think it meets the need of the province's policy mandates to expand into new communities."[26] Other parties spent time during cross-examination taking witnesses to the Minister's letter to the Chair of the Board to test

[22] EB-2015-0179, Ex. A-1-Appendix, p.2, Letter from the Board, Re: Expansion of Natural Gas Distribution, Feb 18 2015
[23] EB-2015-0179, Ex. A-1-Appendix, p.1, Letter from the Minister of Energy to the Chair of the Ontario Energy Board, dated Feb 17 2015
[24] EB-2015-0179, Ex. A-1-Appendix, p., Letter from the Board, Re: Expansion of Natural Gas Distribution, Feb 18 2015
[25] Tr.1, p.201
[26] Tr.5, p.130

whether the proposals in fact did align with the Government's stated policy of encouraging expansion.[27]

1.4.3 SEC submits it is important to put the role of any announced Government policy with respect to natural gas expansion in proper legal context as it relates to this proceeding. While the Board may have initiated this proceeding on the basis of a request from the Minister to further the Government's policy's objective, it does not bind the Board in anyway.

1.4.4 The Board is required to determine independently if the proposals by the utilities, and the applications that underlie them, are appropriate.

1.4.5 The Board must ensure that any expansion framework it may create is permissible both as a matter of law or policy, consistent with its statutory mandate under the *OEB Act*, and specific to this proceeding, the *Municipal Franchise Act*. The Board must ensure that any new framework will lead to just and reasonable rates for new and existing customers, and that the necessary infrastructure required to be built is in the public interest.[28] Furthermore, it must exercise that authority in furtherance of its statutory objectives. [29] Those objectives guide and define its authority and tailor it to the specifics of the proceeding. They act as an interpretive tool.[30] For the purposes of this proceeding, the relevant objectives are:[31]

> 1. To facilitate competition in the sale of gas to users.
> 2. To protect the interests of consumers with respect to prices and the reliability and quality of gas service.
> 3. To facilitate rational expansion of transmission and distribution systems.

1.4.6 The *OEB Act*, in some circumstances, does require consideration of Government policy in exercise of authority. For example, the Board is required to "promote energy conservation and energy efficiency in accordance with the policies of the Government of

[27] For example, see Tr.1, p.99, 216; Tr.4, p.207; Tr.5, p.190
[28] *OEB Act* 36(3), 96(1)
[29] *Bell Canada v. Bell Aliant Regional Communications*, [2009] 2 S.C.R. 764, para. 53
[30] *Electricity Distributors Assn. v. Ontario (Energy Board),* 2013 ONSC 3118, para. 60
[31] *OEB Act*, s.(2)

Ontario" pursuant to section 2(5) of the *OEB Act.*[32] Expansion of natural gas does not further that objective. The Government could have chosen to issue a directive pursuant to its policy directive authority under section 27(1) of the *OEC Act*[33] to require the Board to consider the objective of expanding natural gas service to unserved communities in any application. It has chosen not to do so. A letter to the Chair is not a directive under the *OEB Act*.[34]

1.4.7 This is not to say that the Board should not consider Government policy in this proceeding. It should, but not for the purpose of it being used as authority that the Board is required to issue exemptions from EBO 188 or implement any proposal for a new framework for expansion of natural gas to unserved communities. Where Government policy is important in this proceeding is ensuring that the inputs to the Board's framework take into account Government policy. For example, as the Board recognized in its Issues List, it will need to determine how to treat both the proposed loan and grant programs, and cap and trade, in the economic evaluation.[35] In addition, the Board will need to determine the impact of the recently announced Climate Action Plan.

[32] *OEB Act*, s.2(5)
[33] *OEB Act*. Section 27(1):
Policy directives
27. (1) The Minister may issue, and the Board shall implement, policy directives that have been approved by the Lieutenant Governor in Council concerning general policy and the objectives to be pursued by the Board. 1998, c. 15, Sched. B, s. 27 (1).
[34] List of Directives Issues to the Board
<http://www.ontarioenergyboard.ca/OEB/Industry/Regulatory+Proceedings/Directives+Issued+to+the+OEB>
[35] *Decision and Procedural Order No.2*; *Decision on Incomplete Interrogatory Responses*, p.4

2 EBO 188 CHANGES (ISSUES 1, 4-6, 10-11)

2.1 Overview

2.1.1 SEC submits that the Board should consider changes to EBO 188 to allow for more unserved communities to be connected that do not otherwise meet the guidelines. SEC submits there are limitations to the economic feasibility approach in EBO 188 which focus exclusively on ensuring there is no cross-subsidization in expansion projects between new existing customers on an aggregate basis, and limited ones on an individual project basis. It does not reflect other benefits that may accrue by way of expansion.

2.1.2 The Board should also make changes to how unserved communities may pay for natural gas services. Allowing surcharges and other methods of payment, in addition to the current lump sum capital contributions, will provide for more expansion on terms that are fair to both new and existing customers.

2.2 The Problem With EBO 188

2.2.1 The EBO 188 guidelines require that all expansion projects undergo an economic feasibility evaluation by determining the Profitability Index ("PI"). The PI calculation is a discounted cash flow calculation of the cash inflows and outflows to the utility over a 40 year period. If a PI is at 1 or greater, the project is profitable, and all things being equal, will contribute to overall reduction in rates over the time horizon[36]. If the PI is below 1, then it is unprofitable, and will lead to an increase in rates over the time horizon as existing customers subsidize the project. EBO 188 requires that, i) individual expansion projects have a PI of no less than 0.8, ii) all expansion projects undertaken within the previous 12 months have a PI of at least 1 (the Rolling Portfolio), and iii) all expansion projects in a given tear year have a PI greater than 1 (the Investment Portfolio).[37]

2.2.2 Under EBO 188, projects that do not meet the individual PI threshold of 0.8 can still go

[36] Normally projects cause a net increase in rates at the beginning, but over time the impact on rates declines until it becomes negative. Existing customers pay a little more at the beginning, but are in effect investing to get a benefit later when their rates are lower than they would otherwise have been.

[37] *EBO 188,* Appendix B - *Ontario Energy Board Guidelines For Assessing and Reporting on Natural Gas System Expansion in Ontario*

ahead, but the customer is required to pay a contribution in aid of construction ("CIAC").[38] A CIAC is an upfront amount that represents the difference between the project's forecast PI, and the present value of the additional revenue needed to get to 0.8.[39] For those who are willing to make a CIAC, they do so because the benefits to them from natural gas, over time, exceed the amount of the payment. Many of them are not willing to make the CIAC payment, even though they would receive benefits that exceed the amount of the payment. This is one of the major problems identified for why the utilities and municipalities are asking for changes to EBO 188. The reason is that CIAC's have been sought from interested customers, or the municipalities, and require the amount of money up front. Most of the unserved communities are small municipalities, and the customers are not big industrials who have access to the required financing and can simply afford to pay such large CIACs.[40] The benefits to the communities and the customers may take years to be realized, primarily through lower heating bills, but these costs are all upfront. This includes not just CIAC costs but customer's individual conversion costs. This timing mismatch is a significant impediment. Illustrative of this is that, based on Union's original 30 proposed projects in EB-2015-0179, even though each new customer would realize savings of $34,000 per person over a 40 year time horizon, they would have to pay an upfront CIAC of approximately $7,500.[41]As Mr. Okrucky stated on behalf of Union, "it's the up-front aid that is the major challenge that essentially makes it unreachable for them."[42]

2.2.3 Both Enbridge and Union have attempted to address this problem in their proposals, in part, by seeking to be allowed to charge rate surcharges. Enbridge's System Expansion Surcharge ("SES") and Union's Temporary Expansion Surcharge ("TES") are attempts to bridge the gap between when the benefits occur to new customers and when they have to pay the CIAC. In essence, a surcharge function as a form of a financed CIAC at the

[38] *EBO 188*, s. 4.1.3
[39] *EBO 188*
[40] Tr.1, p.7; Tr.4, p.167; For a list of the CIACs required for Enbridge for example, see Enbridge Evidence, p.27, Table 5.
[41] EB-2015-0179 B.Staff.1; Tr.5, p.119; Tr.5, p.120
[42] Tr.5, p.122

utilities average pre-tax weighted cost of capital.[43] SEC submits the Board should allow utilities to charge expansion surcharges. While it would lead to differing rates being paid over a utilities service territory, it is not unjustly discriminatory, since the surcharge represents the differing cost to serve.

2.2.4 Neither utility is proposing to charge their respective expansion surcharges at a rate that would require the customers in the unserved communities either individually, or as a portfolio, to make up the full difference between the project's PI and the respective 0.8 or 1.0 requirement under EBO 188. Both utilities have proposed these expansion surcharges to be set at $\$0.23/m^3$, and for Union, only stay in place for a maximum of 10 years from when the project first goes in-service. Enbridge has proposed that the surcharge be in place for 40 years. Both utility's rationale for not setting the expansion surcharge at the rate that would produce a PI that meets the EBO 188 is that it would make the payback period too long. To be clear, it is not that there would not be lifetime savings, but that the payback period, the point at which the total savings from the switch to natural gas compared to their previous source, equals the upfront costs to convert to natural gas on their side of the meter (i.e. upgrading to a natural furnace and gas water heater), is too long. The utilities have argued that the payback period needs to be sufficiently short or customers will not convert. For Union, the TES was set at $\$0.23/m^3$ so that the payback period was, on average, 4 years.[44] Enbridge appears to have selected the SES at the same rate simply to match Union.

2.2.5 Individual customers tend not to consider long-term benefits on a purely rational economic basis. Even if an expansion surcharge replaces a CIAC, a customer still has its own behind-the-meter conversion costs which range from an average of $1,500 for someone presently using propane for heating, to $7,250 for someone using electricity

[43] SEC notes another major difference is that it is not being proposed using the same regulatory accounting treatment as a CIAC. A CIAC is considered offset to rate base to lower the projects costs, whereas the TES and SES would simply be treated as distribution revenue. This has the effect of making it more expensive for a new customer to have the CIAC finances through a SES/TES as have been proposed versus taking out a loan to pay it up front at the same rate as the utilities weight average cost of capital.
[44] Tr.5, p.126

heating.[45] It is this gap between the objective calculations of the long-term benefits that could accrue to new customers by switching to natural gas, and what they will actually do, that has led to the proposals from the utilities for cross-subsidization from existing to new customers. SEC recognizes this gap is real. It is similar to why, in the DSM context, incentives are paid to the customer even though the customer, over a period of time, is financially better off making the efficiency investment. The difference here is that the only beneficiaries are these new customers. In DSM, the system as a whole benefits from the efficiency investments. It is why the Board must ensure that an appropriate balance is made between providing subsidies which are paid for by existing customers, and realizing that the beneficiaries are exclusively the new customers, and the utility. The balance must ensure that the benefit to new customers alone, substantially outweighs the cost to existing customers.

2.2.6 There is no evidence that the average payback period Union has determined as required is accurate. Union based this by determining that average Ontario homeowners live in their home for 16 years, and more than 57% of homeowners without natural gas have already lived in their home for at least 10 years. Based on that generic province-wide data, 4 years ensures the payback period will occur for most while they still live in their home.[46] Regardless of the representativeness of the data, the analysis ignores a very significant benefit to homeowners, even if they do not receive the payback (using the way the EBO 134 Stage 2 calculation works) during their time living in the home, and that is, its increased value. This is similar to how many people spend a lot of money renovating their home before its sale, even though they will never get to enjoy it. The increased value of the home is likely to shorten the payback period, as they will recoup it all (and potentially more) on the sale of the home. This information was never put or asked to forecast customers in the market surveys that Union undertook.[47] SEC submits the payback period Union has proposed is likely to be short, and if a proper outreach and education campaign was undertaken, would help potential customers understand this.

[45] Enbridge Evidence, p.15, Table 1
[46] EB-2015-0179 B.CCC.7
[47] EB-2015-0179, B.SEC.9, Attach 1; EB-2015-0179 B.CCC.7

2.3 Benefits of Utilities Proposals Overstated

2.3.1 Enbridge and Union have used the Board's EBO 134[48] economic feasibility approach to justify when, even if expansion does not meet the PI requirements of EBO 188 (Stage 1 under EBO 134), it is still economic and in the public interest. SEC submits the Board should be very cautious of incorporating Stage 2 and 3 analysis under EBO 134, which involve measuring other public interest factors.[49]

2.3.2 First, when viewed from on aggregate basis, their justifications mask how many individual community expansion projects provide an overall negative benefit even after energy cost savings are taken into account. As demonstrated by the Payback Analysis (K2.1) prepared by the Consumers Council of Canada ("CCC"), for Enbridge, most individual expansion projects have negative payback periods, many very significant, meaning they will never provide for a positive benefits when stage 1 and 2 of EBO 134 are combined.[50]

2.3.3 Second, EBO 134 has been historically used for the purpose of evaluating the economics of transmission pipeline expansion.[51] This makes sense since the calculation of other benefits is a much simpler calculation because it is primarily a determined of gas savings on a like-for-like basis, as it comparing landed cost of gas may change from one supply source to another. Calculating price differentials of various basins projected over 40 years is hard enough in the transmission context; comparing price differentials of different fuel sources is significantly more difficult. There was much debate while determining the cost differential for a single point in time between the cost of natural gas and propane alone. [52]

2.3.4 Lastly, both Enbridge and Union's analysis simply take different forms of simple

[48] *Report of the Board* (EBO 134), June 1 1987
[49] Stage 2 includes all other quantifiable costs and benefits not included in Stage 1. Stage 3 includes all other non-quantifiable benefits not included in either of the prefvious tagers. (See Filing Guidelines on the Economic Tests for Transmission Pipeline Applications (EB-2012-0092), February 21 2013, p.1)
[50] K2.1
[51] Filing Guidelines on the Economic Tests for Transmission Pipeline Applications (EB-2012-0092), February 21 2013, p.1
[52] See for example cross examination of Enbridge by Parkland Inc. (Tr.1, p.164-168), Union Gas by Parkland Inc. (Vol.5 p.108-115), Union Gas by CPA. (Tr.6, p.199-202), Enbridge Gas by the Canadian Propane Association ("CPA") and Dr. Yatchew (EPCOR) by the CPA (Tr.7, p.86-89)

approximations of the current heating fuel type in an unserved community. They then assume it applies for all communities, and then determine, based on a recent single point in time, the difference between that source and natural gas, to then comes up with a the fuel cost savingss (or lack thereof). They then add in the conversion costs and multiply the fuel cost differential for 40 years.[53] While this has the benefit of simplicity, in no way is it a reflection of reality where fuel costs change relative to each other all the time. Further, it does not take into account Government policy, with respect to reducing GHG emissions and the pricing of carbon. This alone will dramatically change the differentials in the next few years, let alone the next 40. Neither Enbridge nor Union has included changing differentials due to cap and trade, or the impact of various programs from the recently announced Climate Action Plan.[54]

2.3.5 This problem is compounded when trying to determine the cost differentials for other sources that differ from the current make-up in any community. Since the calculations are based on natural gas as compared to the existing fuel source, they do not capture the costs for other sources of energy that are not currently being used but are more cost effective, or existing sources that should simply be expanded, or the effect on the cost of alternatives of increased economies of scale. A proper calculation requires understanding the potential savings for the customers of converting from their current type to natural gas, but what is the potential difference in savings that could be achieved by switching to another fuel/energy type. Both Enbridge's and Union's current calculation only compares natural gas to the status quo heating fuel makeup as a whole, not against all other sources.

2.3.6 This is especially important going forward where what may not be cost-effective sources of energy today due to the conversion costs, such as geothermal, become much more economical in the future due to cap and trade, and announced subsidies to be provided by the Climate Action Plan.[55] For example, geothermal's major drawback as an energy supply source is its high conversion costs. The Climate Action Plan includes $400M-$800M of funding in 2017-2020 to support SEC member schools and other large public

[53] See EB-2015-0179, Ex.B.CPA.18
[54] *Climate Action Plan*
[55] *Climate Action Plan*, p.26-27, 88

institutions in the installation of energy efficiency and renewal energy technologies, including specifically, geothermal systems.[56] This will certainly change the cost savings that a school may get from natural gas as compared to geothermal.

2.3.7 Lastly, any attempt by parties to justify expansion to unserved communities using not just energy conversion savings (and costs) but also broader economic and social benefits, while not impossible, is both very difficult and more problematically, very subjective. For example, while there may be GDP and tax revenue benefits for a new commercial or industrial facility opening up because of the availability of natural gas, it is only a benefit to the province as a whole if it can be demonstrated that the facility would not simply have opened up somewhere else in the province. There is also offsetting economic and social impacts that would need to be calculated. For all the economic benefits of energy savings to new communities, there are some offsetting costs such as the loss of jobs for those currently employed selling and delivering competing energy sources (i.e. the propane industry). This is not to say that this approach has no merit; it does. It is just that it is almost impossible to measure accurately.

2.4 Economic Feasibility Calculations Issues

2.4.1 SEC believes the economic evaluations that have been done by Enbridge and Union under EBO 188 and EBO 134 in this proceeding are flawed, and do not reveal the true costs, savings, and PI of the projects.

2.4.2 The major problem is the current method of how both Enbridge and Union forecast attachments. Getting the calculation right is of utmost importance. SEC submits the Board must ensure the guidance is included in any framework it may issue, about how to properly calculate the PI.

2.4.3 ***Getting the EBO 188 Calculation Right.*** The most important part of that is the EBO 188 PI calculation (Stage 1 under EBO 134). The PI determines which projects can and cannot go ahead, as set out in EBO 188 and the proposed exemptions sought by both

[56] *Climate Action Plan*, p.26

Union and Enbridge in their proposals in this proceeding. Therefore, the importance of getting the PI analysis right cannot be understated. Since it is a discounted cash flow analysis over 40 years, the final actual PI will not be known until the end of the 40 year period. There are few ways to determine if the actual PI will be different from the forecast PI until many years into assets time horizon, and even so, the project will already have been undertaken and the facilities will have been built. The calculation is done by both utilities, which has the effect of over-stating the profitability of their proposed projects. This will lead to greater cross-subsidization, and a higher risk of stranded assets.

2.4.4 More importantly, both Union and Enbridge have designed their threshold PI portions of their proposals (0.4 per project for Union, and 0.5 for the portfolio for Enbridge) not based on some objective external standard, but simply as a way to bring forward, in their view, a sufficient number of projects. As Union put it, it chose 0.4 as the threshold PI "to strike a balance between the numbers of potential customers who could gain access, and the impact on existing ratepayers."[57] Enbridge chose their approach because "there would be very few communities that would have met the feasibility test that was embedded in Union's proposal.[58]"

2.4.5 The major problem is the current method of how both Enbridge and Union forecast attachment and the volume forecast. Because of this the PI, which is a forecast, is overstated. This has the result of potentially allowing more projects to go ahead than should, and those that do, resulting in fewer customers who will benefit, and rate impact on existing customers will be much higher than forecast.

2.4.6 Attachment in the PI calculation is made up of two different elements. The first is the number of existing homes and businesses (potential customers) that will convert to natural gas (forecast customers). The second is when there are new, not existing, potential customers that connect. This is generally new homes that are constructed at some point within the time horizon of the PI calculation. Using that information, the utilities take the

[57] EB-2015-0179 B.SEC.13
[58] Tr.1, p.10

number of customers and multiply it by a volume type (average use per customer by type).

2.4.7 The Board must ensure that, when a utility is undertaking an economic feasibility calculation to determine if it meets the EBO 188 guidelines as is, or if any exemption may be allowed under a community expansion framework, accurate, forward looking and community specific customer forecasts and volumes are developed.

2.4.8 ***Conversion Rate.*** Enbridge and Union have taken very different approaches with respect to the conversion rate between potential customers and forecast customers. Enbridge is forecasting 75% conversion for all projects, which was based on a survey of only two communities (Fenelon Falls and Bobcaygeon).[59] This is significantly higher than its experience with previous expansion projects where less than 58% of the forecast, let alone the potential customers, attached.[60] Union on the other hand has taken the view that 45% of potential customers will convert within the first 10 years.[61]

2.4.9 There is also a difference with respect to how the utilities forecast commercial and industrial customers. Enbridge only included them if it had done detailed assessments, which to date it had only done for two communities.[62] This is even though Enbridge does expect commercial and industrial customers in these communities.[63] The problem is one cannot consider this a conservative approach since Enbridge does not know if the commercial or industrial customers will directionally increase or decrease due to the specific costs to connect these more expensive customers.[64] Union has completely excluded all contract commercial and industrial customers.[65]

2.4.10 A generic conversion rate approach is also not useful. As can be seen from recent history, conversion rates differ depending on communities. For example, Union's Red Lake

[59] S3.EGD.SEC.17
[60] S3.EGD BOMA.26
[61] Tr.6, p.139
[62] Tr.1, p.46
[63] Tr.1, p.46
[64] Tr.1, p.48-49
[65] Tr.4, p.52-53

project has a very high conversion rate.[66] Whereas mentioned above, Enbridge's rate for its lone conversion project in the last 10 years is substantially less.

2.4.11 This is likely due to many unique features, most importantly, the current energy sources which will affect both the conversion costs and potential savings. This discrepancy will only increase, with the addition of the expansion surcharges (SES or TES) which will increase the price for natural gas in those communities. Further, as will be discussed later, the issue will likely be made even more complicated by the effects of cap and trade which, depending on the potential customers' current source of heating, may cause significant changes in the cost differentials. This will be especially important depending on the customer mix as some will be more inelastic to the changing price of carbon.

2.4.12 The Board must require that a fulsome, forward-looking, and community-specific costumer forecast be used to determine conversion rates of existing customers, which includes all forecast customers, be it residential, commercial or industrial.

2.4.13 ***New Customers.*** The second important element is the forecast of new customers from new homes and buildings, which will be built and will connect to the system within the expansion the community.

2.4.14 For those new customers, Enbridge and Union both expect 100% natural gas penetration.[67] Based on past experience, this makes sense. As new subdivisions develop, all the homes are built with natural gas connections. The concern is that the future will look very different from the past. With cap and trade and the Climate Action Plan, it is not clear if all new buildings in a community with access to natural gas will decide to connect. They may choose various alternative district energy models of renewable energy which will heat the home. This may be especially likely if new building codes are enacted, and/or subsidies are provided, to encourage these alternative approaches.

[66] Union forecasted of the 1,265 private dwellings in the Red Lake Project area, 1071 would connect within the first ten years for a forecast conversion rate of 85%. As of end of year 4 (2015), 801 of the forecast 883 had converted for 94.3% conversion rate. (See J.6.10; EB-2015-0179, B.Staff.14, Appendix)
[67] Tr.1, p.166-167. Tr.3, p.106

2.4.15 SEC submits that forecasting future customers to have a 100% penetration rate is not reasonable anymore. With the greenhouse gas emission targets set by the government through legislation, and through the cap and trade program, there will be a significant shift from natural gas use relative to past experience, potentially within the next 5 years, let alone the next 10 or more. SEC submits as specifics of the provincial programs are released, and cap-and-trade customer forecasts are developed, they should be incorporated into revised conversion rates and new customer penetration rates.

2.4.16 All of this also assumes that none of the customers will leave the natural gas system within the 40 year time horizon. With the reductions in natural gas needed to meet provincial targets, and the expected price of carbon required to meet those targets by 2050, it is very likely that customers who may convert to natural gas now will switch to some other source at some point in the future. Even if that occurs in years 30 to 40, it will have an effect of reducing revenues and lowering the PI.

2.4.17 ***Average Use Will Decline***. Under the current EBO 188 methodology which both utilities do not seek to change, the volumes that are part of the derivation into the revenue per customer do not change in each year of the calculation. While historically this may have been appropriate, it is not anymore. Average use per customer due to cap and trade and the Climate Change Action are likely to decrease, and will likely have to do over the next 40 years. Enbridge's own consultant ICF, expects its residential volumes to decline by 40% and industrial volumes 20-30% by 2030.[68] Neither Enbridge nor Union have done a long-term average use per customer forecast that includes the impacts of cap and trade.[69]

2.4.18 The effect of this is that the revenue per customer shown in the calculation is much higher than will actually be the case. Since the capital costs of expansion are paid upfront and will not change, the calculations using the current EBO 188 methodology leads to potentially significant higher PI than is actually the case. The significance of existing

[68] S3.EGDI.ED.6, p.15
[69] J1.1; Tr.6, p.141

customers will be required to subsidize an even greater portion of the expansion costs.

2.4.19 The Board must ensure that the volumes used in calculations revenue vary from year to year to take into account changes in average use per customer caused by cap and trade. The utilities should be required to include long-term average use forecasts in their economic feasibility calculations.

2.5 What is a community?

2.5.1 SEC accepts that for the purpose of this proceeding, a reasonable definition of community is that of 50 potential first time customers where the homes and businesses already exist, which has been proposed by both Union and Enbridge.

2.5.2 There is no need for additional requirements such as all potential customers being in the same legal municipality. All that should be required is the 50 potential customers be connected through a contiguous new main system.

2.5.3 The size of the community is not such an important factor. This is especially true since while there may be a threshold for potential customers, what is important for the economic feasibility and analysis is the forecast customers.

2.5.4 The concern SEC has is how that definition of community relates to the definition of Small Main Extension Projects, insofar as the exemptions to EB 188 are the same as Community Expansion Projects for each utility. This is because if those customers have the same rate treatment and exemption rules as Community Expansion Projects, then there is essentially no limit for potential customers.[70]

2.5.5 This is evident in Enbridge's proposal. Its Small Main Expansion Project would cover all similar expansions where there are less than 50 potential customers. At the same time, the same rules regarding the application of the SES and the exemption of the EB 188 rolling

[70] J3.6

portfolio would apply.[71] The only difference, as SEC understands it, is that no ITE is required from the municipalities. This has the effect of allowing any existing home or businesses, if the expansion meets the economic evaluation requirements Enbridge has proposed, to be connected regardless of the size of the cluster of customers. As Enbridge's witness admitted, there is no practical effect to the distinction.[72]

2.5.6 The definition of Small Main Extension projects must ensure that projects that would not qualify as a Community Expansion Project will not be able to simply be done through the Small Main Extension Project. For example, if a municipality is not willing to agree to an ITE, under Enbridge's definition, it could simply break up that proposed Community Expansion Project into small pieces each less than 50 potential customers and then do them each as Small Main Extension projects. The Board must ensure that this does not occur.

2.6 Expansion Surcharges (TES/SES)

2.6.1 SEC submits that permitting utilities to charge expansion surcharges is appropriate, but the proposals by Enbridge and Union to set one uniform expansion surcharge rate for all Community Expansion Projects should not be accepted.

2.6.2 If the purpose of the expansion surcharge is to give customers of uneconomic expansions access to natural gas for their benefit only, then the surcharge should be tailored to match the cost/benefit of that specific project. For example, the more uneconomic the expansion project is (measured in PI) and the greater the benefit in terms of energy savings to those new customers, the higher the expansion surcharge should be.

2.6.3 None of the proposed expansion projects will reach a PI of 0.8 or 1.0 with the proposed \$0.23/m^3 TES/SES. Further, lengthening the period of time when expansion surcharge is in place will not alone be a sufficient adjustment.[73] SEC submits that the Board should, at

[71] Tr.3, p.121
[72] *Ibid*
[73] Enbridge indicates in S3.EGDI.VECC.3 that its SES will be in place for 40 years.

the very least, accept Enbridge's proposal as opposed to Union's[74], where the term to charge the expansion surcharge is for the lesser of 40 years, or when the project reaches a PI of 1.0.[75] The reality is, however, that the surcharge for Enbridge will never be in place for less than 40 years. Enbridge does not forecast a single project to reach a PI of 1.0, even with the SES in place for 40 years. In fact, none even come close.[76]

2.6.4 What matters more than the length of time the expansion surcharge is in place, is its amount. Ideally the Board would not allow the utilities to set a specific expansion surcharge, but allow them to come forward in individual applications to set them based on the specific circumstances related to each proposed expansion project. The rate would depend on how uneconomic the specific project (the PI) is, and how big the benefit would be to the community (the EBO Stage 2 benefits).

2.6.5 SEC recognizes the reluctance the utilities would have for such an approach as it would require an individual expansion surcharge for each new community. It would mean the need for dozens of different rate schedules for each utility. But simply setting one expansion surcharge rate is unfair. For example, it means that the new customers of the proposed expansion projects in the communities of Town of Marsville, are paying the same amount as those in Fenlon Falls & Bobcayegon, even though the former is half as profitable. Furthermore, there may very well be a very significant difference in the energy savings benefits from one community to another depending on the current fuel mix. For example, based on Enbridge's own (flawed[77]) calculations, a community that is currently primarily served by propane heating will benefit much more by switching to natural gas than a community that is primarily served through electricity for heating.[78]

2.6.6 SEC submits if the Board believes that unique expansion surcharges for each project is

[74] Union's proposal is the TES be in place for at least 4 years, and then until the lesser of when the project meets a P.I. of 0.4 or 10 years.
[75] Enbridge forecasts all of its proposed projects to have a TES in place for 40 years.
[76] Enbridge Evidence, p.27, Table 5
[77] SEC noted Enbridge's calculation are flawed as discussed earlier since it does not take into account cap and trade costs which will have a significant effect on the price of propane.
[78] Based on Enbridge's calculations using its proposed SES rate, the payback period for a customer switching from natural gas to propane is 1.4 years, whereas for electricity it is 2.8 years. (Enbridge Evidence, p.15, Table 1)

not practical, then it should determine a few (3-5) different rates that could be applied to different bands for projects, based not only on the their individual profitability, but also the benefits the new customers receive. This would properly balance not just the level of subsidization from existing to new customers, but also between new customers. The proposed list of expansion projects by both Union and Enbridge are very diverse, and the expansion rates should reflect this.

2.7 Municipal Contributions (Incremental Tax Equivalent)

2.7.1 Both Enbridge and Union have proposed that they would require municipalities of expansion projects to rebate back the incremental taxes they receive from the utilities for serving the community for 10 years (the "Incremental Tax Equivalent" or "ITE"). This would serve as additional revenue to offset the required subsidy.

2.7.2 SEC submits this is an appropriate requirement, especially considering the municipalities will be receiving significant benefits, both by becoming customers themselves, and more importantly, from increased municipal tax revenue from new businesses and residents being attracted to the communities because of natural gas service. Ultimately, the ITE will not make up a significant portion of the total amount collected from all sources. For Enbridge, it would represent only $12.99M collected of a total of $867M over 40 years.[79] But it is an important source since usually it is the municipality, not individual customers in the communities, who are required to pay the CIAC to reach the PI threshold under EBO 188.

2.7.3 SEC submits changes are required. First, the Board should require the ITE be in place, similar to Enbridge's proposed SES, for the entire 40 years or until the project meets the minimum PI. If unserved communities across the province want natural gas as badly as they appear to be telling the Board, then they should pay their fair share.

2.7.4 Second, for unserved communities governed by both an upper and lower tier

[79] S3.EGDI.SEC.22

municipality, the ITE should be the portion paid for both tiers.[80] There is no reason that a community that falls within a single-tiered municipality should pay more than one that is split into two levels. When questioned about this during the hearing, both Enbridge[81] and Union[82] appear to agree. The Board should mandate this so it is clear not just to the utilities but for municipalities across the province interested in bringing gas service to their unserved communities.

2.7.5 Lastly, both Enbridge and Union propose that the municipalities only rebate back the pipeline property taxes they are required to pay.[83] It does not include property taxes they would pay on any building or land they may own in the municipality, to service the expansion project. SEC submits the municipalities should be required to rebate back to the utility all incremental property taxes that, from whatever source, the utility is required to pay for an expansion project. Both should be rebated back to offset the subsidy that is being required to be paid. SEC recognizes a municipality will incur municipal costs to service any facilities that a utility may own, but the benefit the community will receive as discussed above will be much more significant.

2.8 Regulatory Treatment of the SES/TES and ITE

2.8.1 Both Enbridge and Union have proposed that their respective expansion surcharges (SES/TES) and the ITE should be treated as revenue, as opposed to how CIAC are treated. In their view, customers are better off by treating these amounts collected as general revenue, as opposed to a credit to lower rate base as CIAC would do.[84]

2.8.2 SEC disagrees with the analysis provided by Union to demonstrate this supposed benefit to ratepayers. SEC has reviewed the submissions of the London Property Management Association ("LPMA") on this issue and agrees with its analysis. The problem with Union's calculation of the benefit of its approach is premised on calculating the net

[80] In a community that is governed by both an upper and lower tiered municipality, the lower tier municipality collects the property taxes for both tiers, and then forward the upper tiers portion to them.
[81] Tr.1, p.50-51
[82] Tr.5, p.133
[83] Tr.5, p.133-134
[84] For example, see EB-2015-0170 B.LPMA.1

present value of the net revenue requirement[85] of the scenarios over a 40 year period. Using a net revenue equipment approach is not the appropriate method since what it represents is the cost that only existing customers will have to pay, not both existing and new customers. Based on a revenue requirement calculation, the revenue treatment results in a total of an additional $3M payable by all ratepayers as compared to, if it was treated similar to a CIAC.[86] On a net present value basis the amount is $1.3M or 25% more.[87]

2.8.3 SEC does differ with LPMA with one respect. SEC submits the ITE should also be treated similar to the CIAC. While the ITE is a credit on some municipal taxes payable, it is also being proposed to compensate for the lack of CIAC being required to be paid.

2.9 Proposal Profitability Parameters

2.9.1 Both Enbridge and Union have proposed profitability and rate parameters that would create boundaries for the number and type of Community Expansion Projects that they would be allowed to undertake. A proper balance must be struck to determine an appropriate minimum PI as well as the appropriate rate impact. Neither Enbridge's nor Union's proposals have done that. Setting the appropriate boundaries is important because while the Board has heard from many communities, directly or through the utilities, about how they want natural gas service, no information was provided about the views of current ratepayers from the utilities. So while Enbridge has surveyed some customers in communities to which it seeks to bring natural gas, it made no effort to seek the views of the existing customers who will be subsidizing them.[88]

2.9.2 SEC submits the proposals by Enbridge and Union do not provide for a fair balance and proposes the changes as set out below:

[85] Net revenue requirement revenue requirement minus the expansion surcharge (SES/TES) and ITE.
[86] See the detailed submissions of the LPMA for full information on these calculations.
[87] *Ibid.*
[88] Tr.1, p.40-41

	Enbridge Proposal	Union Proposal	SEC Proposal
Minimum Project PI	No minimum	0.4 after including TES and ITE	0.6 after including TES/SES and ITE
Project Portfolio Requirements	0.5	0.4 implied from min Project PI	0.6 implied from minimum Project PI
Existing Customer Residential Rate Impact Ceiling	$2/month	$2/month	No more than 2% of the delivery bill for all customer classes.
Other Requirements			For each project, sum of Stage 1 and 2 must be positive; Each project must also be shown to be the most cost effective option for that community.

2.9.3 ***Minimum Project PI.*** The Board should set a minimum project PI, after the inclusion of the expansion surcharge and ITE. Union has proposed a minimum project PI of 0.4, whereas Enbridge has not proposed one. SEC submits that it is important to ensure not just that the total portfolio of expansion projects meets the minimum PI as proposed by Enbridge, but that there is an individual threshold that each project should meet. To strike this balance between wanting to expand natural gas to unserved communities, and fairness to existing ratepayers who will have to subsidize those projects, there must be a limit to how uneconomic the projects can be under the EBO 188 methodology.

2.9.4 This approach is consistent with the Board's decision in EBO 188, where it required that it was not sufficient to have a portfolio of projects that have a PI of 1, but that each individual project have a minimum PI. [89] The Board recognized it was important to ensure "fairness and equity".[90]

2.9.5 It is also not fair to unserved communities to not have an individual project minimum PI but only have a portfolio minimum PI. Some potential projects, whose individual PI's are below the minimum portfolio PI, will go forward and others will not. Under Enbridge's

[89] *EBO 188*, para. 4.3.0-4.3.2
[90] *EBO 188*, para. 4.3.2

proposal, it is very likely that less profitable projects which have fewer customers will be able to go forward, as compared to larger ones that are more profitable because it will have a smaller effect on the overall portfolio PI. This is not fair to unserved communities and would not give them any certainty that their project will ever go forward.

2.9.6 Furthermore, SEC is also concerned that allowing the utilities such broad discretion in picking which projects go forward and which do not, could be used for anti-competitive purposes both, to prevent alternative options from being promoted,, and implemented within the community. For example, it may lead to communities holding off promoting alternative sources of natural gas service from potentially a new entrant, because they may *think* they will be served by Enbridge at some point in the future. A clear set of standards should be required so all communities know the rules at the beginning of this process.

2.9.7 Enbridge has proposed its approach not on a principled basis, but because of the relative poor economics of its proposed projects as compared to Union.[91] As Mr. McGill readily admitted on behalf of Enbridge, "if we went [Union's] way, there would be very few communities that would have met the feasibility test that was embedded in Union's proposal, which was to attain a project PI of 0.4 or greater."[92] SEC submits this is not a valid rationale. The Board should ensure there is a principled and uniform basis, not just threshold PI's, which are essentially reverse-engineered to allow a large number of projects to go ahead. The minimum project PI should reflect an appropriate balance that is primarily concerned with ensuring that the level of cross-subsidization is appropriate. The question that the Board must ask and answer is not at what PI will the economics convince new customers to attach.

2.9.8 SEC submits a minimum project PI of 0.6, calculated after inclusion of the expansion surcharges and ITE, and strikes the appropriate balance. This allows for an incremental shift of the 0.8 minimum PI set out in EBO 188, and yet, will allow a significant amount

[91] Tr.1, p.9-10
[92] Tr.1, p.10

of new expansions when coupled with expanded revenue that would arise from SEC's proposals with respect to the expansion surcharges and ITE.

2.9.9 ***Project Portfolio PI.*** SEC submits there is no need to require any minimum project portfolio PI requirements since, as discussed already, there should be a minimum project PI. This creates implied minimum portfolio requirement equal to the minimum project PI of 0.6. Enbridge and Union have also proposed that the Community Expansion Project be excluded from the required Investment Portfolio under EBO 188. SEC accepts this approach as it is consistent with the intent of this proceeding.

2.9.10 ***Existing Customer Rate Impacts.*** Both Enbridge and Union have proposed an average residential rate impact ceiling of $2/month, that is, more accurately, $24 a year, for existing ratepayers, for the entire portfolio of Community Expansion Projects. [93] However, they both define what that means differently. Enbridge has stated that it is not an absolute ceiling but a guideline they plan to follow[94], whereas Union considers it an absolute ceiling.[95] No equivalent amount has been proposed for non-residential customers.

2.9.11 Further, even though some may argue $24 a year for residential may not be large in the grand scheme of each utility's rates (on a total bill basis), each small rate increase for each different matter adds up. This is especially the case where there have been large

[93] Tr.6, p.130

[94] Tr.1, p.39:

MR. RUBENSTEIN: If I could ask you to turn to page 7, paragraph 58, bullet point 2, you're talking about the objectives, and you say:

> "To limit the rate impacts on existing customers to a maximum of approximately $2 per month ($24 15 per year) over the multi-year expansion project."

Are you seeking the Board to set that as the ceiling? That is as much as it can go, so even if there is another project and we're at the $2, the Board will not be able to approve that?

MR. MCGILL: No. What we were doing here was describing the parameters that we were operating within in developing our proposal. So one of them was to set a limit 23 on what the average subsidy amount would be per customer, per year. That is what it was. So we set that as a guideline, and we worked within that guideline in coming to our proposal.

[95] Tr.6, p.130:

MR. RUBENSTEIN: So any given year, an average residential consumer will not -- only $24 per month of their total annual bill will represent the subsidy that they will be paying for new community expansions.

MR. OKRUCKY: That's correct, yes.

MR. RUBENSTEIN: And are you seeking that to be a ceiling or a guideline?

MR. OKRUCKY: We're seeking that to be the ceiling.

infrastructure projects approved in the last few years, the approval of DSM plans, and soon, new cap and trade costs.

2.9.12 Average rate impacts are an important measure, but they must be considered in light of the other elements of any proposal. This is because they mask the actual scope of how much is being subsidized simply based on the size of the customer base of the utilities. SEC submits $24 a year for an average residential customer is too much to ask ratepayers to subsidize considering they are receiving no benefits. This works out to be about a 6-7% increase in delivery rates for Union customers[96] and would be similar for Enbridge. For schools alone, that will be millions of dollars over the life of the program.

2.9.13 The bill impact analysis in the evidence is not with respect to the $24 a year amount but the rate impacts of only the proposed projects of Enbridge and Union, which are much less. The problem is they are not seeking approval only to do those projects that they have identified meet their proposals for the framework in their evidence, but potentially many more. This is likely to occur with the Government's announced combined $230M in loans and grants to potentially increase the number of communities that would be eligible for cross-subsidies from existing ratepayers that would not alone meet any of the requirements of any Board framework.[97]

2.9.14 Furthermore, their increase cannot be considered in isolation. This is especially the case where there have been large infrastructure projects approved in the last few years, the approval of DSM plans, and soon, new cap and trade costs. These costs all add up to very significant increases.

2.9.15 Enbridge and Union have said that their $2/month, $24/year rate impact proposal was guided by the Board determination that the same amount was reasonable in the context of the 2015-2020 DSM programs.[98] This is not an appropriate comparison since there are significant differences between the initiatives. Here existing customers receive no benefit,

[96] Tr.5, p.76
[97] For more, see section 5.2
[98] Tr.1, p.39-40; Tr.5, p.75

whereas they do in the DSM context, either directly through being able to participate, or the environmental and social benefits of reduced overall gas consumption.

2.9.16 SEC submits rate impacts significantly less than what is proposed should be set as the maximum allowable under the framework. SEC submits no more than a 2% delivery (as opposed to total bill) rate increase for all customer classes, as compared to the proposed $2/month, $24 /year proposal. To be more piece, that is 2% of the delivery rates at any one time, not year over year increases of 2%. The amount should also be 2%, exclusive of any DSM and cap and trade rate riders.

2.9.17 ***Other Requirements.*** As discussed already, SEC submits the Board should ensure that each proposed expansion project must, without any subsidization, have a positive net present value after Stage 1 and 2 of the EBO 134 economic feasibility analysis. A project that does not, is simply not in the public interest, because even if it is unprofitable from a PI perspective, it is not outweighed by the benefits to those new customers in savings. Even though there is a Stage 3 of the EBO 134 framework which incorporates 'other benefits', SEC submits they are too speculative and lack sufficient rigour to be considered. As demonstrated by analysis done by CCC regarding Enbridge's proposed projects, too many provide no benefits and do not make any rational economic sense.[99] Those projects are not prudent and the Board should not grant leave to construct, a Certificate of Public Convenience and Necessity, or its inclusion in rate base (if no project-specific approvals needed).

2.9.18 Furthermore, the projects must be shown to be the <u>most</u> cost effective way to bring about energy savings benefits, generally lower heating costs, to potential customers in these unserved communities. This means that utilities must not only demonstrate that natural gas expansion is justified compared to the community's current energy sources, but that it is also the most cost effective compared to other possible solutions. So, for example, it must be demonstrated that, taking into account all factors (economic and environmental), other sources of energy such as geothermal or other renewable sources are not a better

[99] K2.1

solution when the full cost is considered. This must be demonstrated on the actual total cost, so without the impact of any subsidization from existing customers.

2.9.19 This is especially important because it is the utilities that will be bringing forward these applications, and it is in their self-interest to minimize the cost effectiveness of competing sources of energy. Whereas today alternative sources of energy may not be economic, if this framework is likely to be in place for the next 20 years, then it is very likely there will be some which are. The Board must ensure that utilities undertake a fair assessment of competing alternatives and present a fair justification for why natural gas is still the preferred solution. The Board must also ensure that it is not picking winners but allowing the most competitive technology to be the supplier of energy in an unserved community.

3 CROSS-SUBSIDY JURISCTION AND PREFERENCE (ISSUES 2-3)

3.1 The Board Can Create a Jurisdiction-Wide Cross Subsidy Regime

3.1.1 If the Board determines that it is appropriate to allow for what is currently considered uneconomic expansion under EBO 188, the Board does have the legal authority to establish a system in which customers of one utility subsidize the expansion undertaken by another utility.

3.1.2 ***Board's Rate-Setting Authority.*** The Supreme Court has confirmed that the Board's rate-making authority is broad.[100] There is no one method in setting rates. The Board has the authority pursuant to section 36(3) to "adopt any method or technique that it considers appropriate".[101] There is no statutory "preferred course of action in rate setting by the Board" under the *OEB Act* for the setting of natural gas rates.[102] All that is required is that the rates be just and reasonable.[103] For rates to be just and reasonable, they must be fair to both ratepayers and utilities. A customer can only be charged rates that reflect the reasonable costs to serve it and the utility must "over the long run, be given the opportunity to recover, through rates it is permitted to charge, its operating and capital cost."[104] This includes its cost of capital.[105] Furthermore, the Board must set just and reasonable rates and it must do so in furtherance of its statutory objectives under the *OEB Act*.[106]

3.1.3 Determining just and reasonable rates does not mean that the Board can only approve rates that reflect the cost to serve each individual customer. As the Divisional Court has said in *Advocacy-Centre for Tenants- Ontario v. Ontario Energy Board*:

> Nor does our conclusion presume as to what methods or techniques may be available in determining "just and reasonable rates" Efficiency and equity

[100] *Ontario (Energy Board) v. Ontario Power Generation Inc*., 2015 SCC 44 ["*OEB v. OPG*"]
[101] *OEB Act*, s.36(3) *Natural Resources Gas Ltd. V. Ontario Energy Board*, [2005] O.J. No. 1520, para. 13
[102] *Advocacy Centre for Tenants-Ontario v. Ontario Energy Board,* [2008] O.J. No. 1970 (Div. Ct) ["*Advocacy-Centre for Tenants"*], para. 57
[103] *OEB Act*, s.36(2)
[104] *OEB v. OPG*, para. 16
[105] *Ibid.*
[106] *OEB v. OPG*, para. 11; *Toronto Hydro-Electric System Limited v. Ontario Energy Board*, 2010 ONCA 284, para. 26-28; *Advocacy Centre for Tenants-Ontario,*), paras. 53-56.

> considerations must be made. Rather, this is to say so long as the global amount of return to the utility based upon a 'cost of service' analysis is achievable, then the rates/prices (and the methods and techniques to determine those rates/prices) to generate that global amount is a matter of the Board's discretion in its ultimate goal and responsibility of approving and fixing "just and reasonable rates".[107] [emphasis added]

3.1.4 What is required is that the global amount of reasonable costs be recovered from ratepayers as a whole through rates. How those costs are allocated between customers is a different consideration where the Board has significant discretion.

3.1.5 This is best illustrated by the specifics of the *Advocacy-Tenants v. Ontario Energy Board* case itself, where the Divisional Court over-turned the Board decision, and ruled that it did have jurisdiction to implement a low-income affordability plan.[108] The court determined that the Board could consider not just strict cost causality but the ability to pay in rate-setting so as to charge differing rates based on economic and income considerations.[109]

3.1.6 SEC submits the Board has the authority, as one method of rate-setting, to allow recovery of community expansions costs from all natural gas customers it regulates. It would also further the statutory objectives for natural gas to promote competition in the sale of gas. As long as the Board ensures an opportunity for utilities to recover the prudent costs for the expansion from ratepayers as a whole, the Board has the authority to create a province-wide subsidy regime which would involve ratepayers of one utility subsidizing expansion of another utility.

3.1.7 A cross-utility or jurisdiction-wide subsidy regime is consistent with the history of just and reasonable rate-setting under the *Telecommunications Act* and its predecessor, the *Railway Act*. Even before a specific section mandating a subsidy regime could be created, the CRTC ordered subsidies to be paid from one regulated entity to another, and thus,

[107] *Advocacy Centre for Tenants-Ontario*, para. 59
[108] *Advocacy Centre for Tenants-Ontario v. Ontario Energy Board*, [2008] O.J. No. 1970 (Div. Ct)
[109] *Ibid*

from ratepayers of one entity for the benefit of the ratepayers of another.[110]

3.1.8 SEC expects that parties will argue that the Board requires explicit legislative authority to authorize such a jurisdiction-wide subsidy regime, evidence of that being section 79 of the *OEB Act* which provides for the Rural Remote Assistance Program for electricity.[111] SEC submits the Board should reject such an argument. Section 79 is in place to require the Board to authorize such a program. It is not optional for the Board to create such a program when setting electricity rates as it is with respect to a similar type of program here for natural gas.

3.1.9 Having the legal jurisdiction to set rates on that basis does not mean it is good regulatory policy. Good rate-making policy is one that provides for cost-causality, to avoid cross-subsidization, so that individual or similarly situated customers pay the rates which they cause the system to incur, yet there is no absolute rule that it is required, as long as the rates are not unjustly discriminatory.[112] In fact, there is never perfect cost-causality, especially when individual utilities, for the most part, charge postage-stamp rates. For example, residential customers of Enbridge pay the same amount for service regardless of their location and the costs to serve them. The cost to serve a home will differ between cities (Toronto versus Ottawa), but also within a city, and even at a much more granular level, by street. In the context of electricity transmission, the Board has created fully postage-stamp rates for the entire province. Toronto's customers' transmission rates include costs for Great Lakes Power, when there is very little chance that the electricity that flows in to their home ever passed through those lines in Northern Ontario. With respect to rates between customer class, there is recognition that cost allocation is far from perfect.

3.1.10 In the present context, there is little practical difference, from the perspective of a Union customer who lives in Oakville, having to subsidize an expansion project in Milverton[113],

[110] S16.VECC.SEC.1
[111] *OEB Act*, s.79
[112] *St. Lawrence Rendering Company Ltd. v. the City of Cornwall*, [1951] O.R. 669, p. 683
[113] EB-2015-0179, Ex.A-1-Appendix D

versus having to subsidize another utility's one somewhere else in the province, since in either case they gain no benefit. In fact, depending on the distance from Oakville, there may be greater public acceptance from existing customers to subsidize a project closer to them. Regardless of whether the Board has jurisdiction to create a province-wide subsidy model or not, the proposals from Union and Enbridge which require substantial exemptions from EB 188, a policy whose explicit intent was to limit cross-subsidization, will require a substantial deviation from the principle of cost-causality.

3.2 Jurisdiction-Wide Cross-Subsidy Is Preferable

3.2.1 SEC submits the Board should, if it determines cross-subsidization is appropriate, do so on a jurisdiction-wide basis. A jurisdiction-wide approach is preferable as it promotes fairness and competition.

3.2.2 ***Fairness To All Existing Ratepayers.*** It would also be fairer for existing ratepayers and in furtherance of the Board's objective to protect consumers with respect to price, if any subsidy is fairly allocated to existing customers. Under the respective proposals from Union and Enbridge, existing customers will have differing actual rate increases across the two utilities simply based on the differing number of expansion projects proposed, and their specific project economics. Union's customers will ultimately be paying more on a per customer basis than an Enbridge customer if the Board approves their proposals.[114] A province-wide regime will allow the amount of the subsidy to be equally allocated amongst all customers, regardless of what utility they are served by, and the expansion project they undertake.

3.2.3 The only fairness concern with a jurisdiction-wide subsidy regime is that not all natural gas ratepayers in the province will be included. The Board does not rate-regulate either Utilities Kingston or Kitchener Utilities, and so is unable to collect any subsidy from them.[115] This is an unfortunate situation, but relative to the ratepayers that are regulated by the Board, these utilities represent a very small proportion of natural gas consumers.

[114] S3.EGDI.IGUA.5; S15.Union.IGUA.6
[115] *OEB Act*, s.36(8)

3.2.4 Based on the evidence filed, the only parties which appear to oppose a jurisdiction-wide cross-subsidy (not to be confused with those who oppose any cross-subsidy) are Enbridge and Union, who have a significant financial motive to take such a position. Based on its report, the main rationale why Union's expert, London Economics Inc. ("LEI"), believes an internal utility cross-subsidization is more efficient is that it is administratively simpler and more transparent than a jurisdiction-wide model.[116] SEC agrees that a utility cross-subsidy is administratively simpler, although it is clearly not more transparent. Many of the other experts in this proceeding disagreed with LEI's conclusions in this regard. While it may be administratively simpler, it is only marginally so, relative to the utilities setting up an internal cross-subsidy system. The evidence of Mr. Todd[117], Mr. Bacon[118], Mr. Hariton[119] and Dr. Yatchew[120] were that setting up such a jurisdiction-wide system would not be administratively difficult or very costly for the Board to do. If the administrative costs are higher, as Mr. Todd said, "the benefits of a competitive process are likely to outweigh the administrative costs."[121]

3.2.5 ***Facilitates Competition.*** The Board should also approve such an approach as it alieves any concerns regarding barriers to entry for new entrants to serve unserved communities who may not have ratepayers in Ontario to draw subsidy from. Competition to bring service to unserved communities by new entrants, or those with small customer bases, is beneficial as it can lead to lower capital costs. See section 4 for further submissions on promotion competition.

3.3 Specific Justification-Wide Model

3.3.1 A few different models have been suggested or referenced during this proceeding. Mr.

[116] London Economics Inc., *Economically efficient approaches to community expansion – expert assistance in the matter of Union Gas Limited's community expansion application (EB-2015-0179),* March 18 2016, p.13-14 (Union Evidence, Schedule 1).
[117] Tr.3, p.260-261
[118] Tr.3, p.260
[119] Tr.4, p.119-120
[120] Tr.7, p.41-42
[121] Tr.3, p.261

Bacon suggested a program analogous to the RRRP for electricity,[122] Dr. Yatchew has proposed his own 'Expansion Reserve' model[123], and both Mr. Todd and Messrs. Hariton and Ladanyi referenced the CRTC's High Cost Serving Area subsidy regime as a potential model[124].

3.3.2 One of the problems is that both Union and Enbridge, who do not support any such model, refused to answer interrogatories related to what type of jurisdiction-wide model would be preferable if the Board went in that direction.[125] Even at the oral hearing, the Board panel Chair had to push them to provide some answers to questions on the issue.[126] While Enbridge specifically said it did not see why these proposals could not be mechanically undertaken, that is not helpful to understanding which one is the most effective. Since Enbridge and Union represent most existing natural gas customers in the province, and are likely to undertake most of the expansion projects, a more useful and fulsome discussion with utilities is necessary.

3.3.3 SEC submits that if the Board believes a jurisdiction-wide model is appropriate, it should either initiate a separate proceeding, or a consultation, to design it. There is not enough information on the record in this proceeding to do so. This approach would not delay any expansion projects. Once the Board creates the framework, leave to construct applications may be undertaken, and at a later date, exactly how the subsidy flows can be worked out. This is similar to what the Board did in Hydro One's leave to construct the Supply to Essex County Transmission Reinforcement Project (EB-2013-0421), where it granted leave, but after realizing that the issues in the Phase 2 cost allocation portion were much more complicated than initially expected, it decided to deal with those issues

[122] Bruce Bacon (BLG), *Rural Rate Assistance as a Ratemaking or Rate Recovery Approach Which the OEB Should Consider When Assessing The Generic Hearing Issues Related to Natural Gas System Expansion* (Evidence of the Municipality of Kincardine Municipality of Arran-Elderslie Township of Huron-Kinloss); R13.South Bruce.SEC.8
[123] Evidence of Dr. Yatchew (Charles River Associates) on behalf of EPCOR, paras. 29-38; S4.EOCOR.Board Staff.8(c)
[124] John Todd (Elenchus Research Associates Inc.), *Mechanisms for Supporting Natural Gas Community Expansion Projects, March 21 2016*, p.17-19 *(*Evidence of the Municipality of Kincardine Municipality of Arran-Elderslie Township of Huron-Kinloss); George Hariton and Tom Ladanyi, *Natural Gas System Expansion and Subsidies in Telecommunications*, p.20-24 (Evidence of VECC)
[125] S3.EGDI.SEC.3; S3.EGDI.CC.2; S15.Union.SEC.2; S15.Union.CCC.2
[126] Tr.1, p.54-56

in a separate policy consultation to be implemented or the project later.[127]

[127] EB-2013-0421, Letter to All Parties, dated August 28 2015

4 COMPETITION FACILITIATES EXPANSION (ISSUES 8-9)

4.1 Competition is Beneficial

4.1.1 SEC supports robust mechanisms for encouraging competition to provide service to unserved communities. Competition in the sale of gas to consumers, which in this case is through the competition of distributors vying to serve a community, is an objective of the Board under the *OEB Act*.[128] Since the current marketplace is dominated by two existing natural gas distributors, Union and Enbridge, allowing new entrants in Ontario to compete to serve unserved communities is important.

4.1.2 Competition to serve new communities is an important way to lower the cost for ratepayers of unserved communities, as utilities will have to compete to enter into a Franchise Agreement, which would be primarily based on proposed forecast costs and rates. An example of this principle applying to traditional monopoly services is the Board's competitive process to determine a proponent to develop and ultimately construct the East-West Transmission Line (EB-2011-0140). The process led to multiple potential proponents who competed before the Board on the basis of, among other things, cost and both, operational and construction experience. SEC generally agrees with Dr. Yatchew's analysis on the benefits of competition.[129]

4.2 Removing Barriers To Competition To Bring Service Unserved Communities.

4.2.1 ***Customer Pool To Draw Upon For Cross-Subsidy.*** SEC submits the fundamental barrier to new entrants being able to even be considered by an unserved community to provide service under Enbridge's and Union's proposals, is that these utilities propose the cross-subsidization of expansion through their existing customer base. Since some cross-subsidization is required for expansion to unserved communities, new entrants who do not have an existing customer base to draw from are put at a significant competitive disadvantage. This is why SEC believes it is appropriate that if the Board determines that exemptions from EBO 188 should be allowed to subsidize new community expansion, a province-wide subsidy regime is most appropriate since that would allow new entrants to

[128] *OEB Act* s.2(1)
[129] Evidence of Dr. Yatchew (Charles River Associates) on behalf of EPCOR, p.10-11

be put on the same footing as existing utilities.

4.2.2 ***Asymmetry of Information***. The other significant barrier is that there is an information asymmetry between potential new entrants and existing natural gas distributors about potential opportunities. Existing natural gas utilities have operations in the province, and communities that seek natural gas service will look to them to connect. As Enbridge and Union have said, they field calls from unserved individuals and communities all the time looking to be connected. These unserved communities seek out Enbridge and Union because they already provide the service in Ontario, and in many cases, nearby. These unserved communities are likely not aware of other potential natural gas utilities who do not currently operate in the province, such as EPCOR. From the perspective of the new entrants, they do not know which unserved community is seeking natural gas service, and as Dr. Yatchew notes on behalf of EPCOR, they do not even know which unserved communities in Ontario have not already signed a Franchise Agreement with either Union or Enbridge.[130] This informational gap is especially problematic when the size of the unserved communities is very small. As Dr. Yatchew stated, "[k]eep in mind that many expansion opportunities are small in size, external candidates are less likely to explore business opportunities unless information is readily available."[131]

4.2.3 The Board should keep a comprehensive database of existing Franchise Agreements, and maps of where natural gas service is currently provided. This is a simple way to eliminate some of these informational barriers that new entrants face. The Board could also keep a registry on its website of all potential companies that may be interested in serving expansion communities. This information would be beneficial to unserved communities to understand that the potential expansion project proponents out there are more than just Enbridge and Union.

4.2.4 ***Opt-Out Clauses*** EPCOR has suggested through the proceeding that it believes that Union and Enbridge are essentially sitting on existing Franchise Agreements with

[130] *Ibid,* , p.17
[131] *Ibid*

unserved municipalities for the purposes of blocking new entrants to potentially serve them.[132] The evidence in this proceeding is not sufficient for SEC to provide an opinion on whether this is occurring. The evidence does show that both Union and Enbridge do have existing Franchise Agreements with municipalities that include communities that they do not currently serve.[133] This is not for some nefarious motive but simply because the economics to serve these franchises would not be allowed under EBO 188. It may very well be that a new entrant could make the economics work to allow the project to proceed under the current EBO 188, or some modified version that results from this proceeding, where the existing Franchise Agreement holder could not.

4.2.5 SEC does support modifying the model Franchise Agreement to provide for opt-out clauses for municipalities after a certain period of time if no service has been established in the community. The Board may use its authority when granting approval to any Franchise Agreement going forward, to make it conditional upon service being provided within a reasonable time frame. This would mitigate EPCOR's concerns regarding utilities sitting on Franchise Agreements.

4.3 Competitive Selection Processes

4.3.1 One of the most effective ways that competition for unserved communities can be promoted is through a competitive selection process. SEC submits that ideally, formal processes such as requests for proposal ("RFP") or requests for information ("RFI"), conducted properly with a selection system based primarily on rates and reliability, would lead to the most cost-effective provider of natural gas for an unserved community. SEC supports such a proposal, although recognizes the practical difficulties of requiring it.

4.3.2 While unserved communities such as the South Bruce municipalities[134], which includes Kincardine, the largest unserved community on either the Enbridge or Union list of potential projects, held a formal RFI process, it may very well not be practical or cost

[132] See for example, Tr.3, p.59-61
[133] S3.EGDI.EPCOR.1; S15.Union.EPCOR.4
[134] Municipality of Kincardine Municipality of Arran-Elderslie Township of Huron-Kinloss

effective for many of the very small unserved communities to do so. Many of these communities are made up of just a couple of hundred potential customers. They may not have the funds to retain experts and legal counsel for a process such as was done in South Bruce. At the same time, existing customers are the ones who also benefit from competition to serve these unserved communities. Lower costs to serve a community mean the level of subsidy to be paid from existing customers is smaller. If existing customers are being required to subsidize expansion to unserved communities, then it is only fair that the Board require those communities to undertake a process that helps to ensure that the utility who serves it, will be doing it at the lowest possible cost. A competitive process to select that utility is one of the best ways to ensure that happens.

4.3.3 SEC recommends that the Board not require any specific type of competitive process to be undertaken. The expectation the Board should set is that the larger the potential Community Expansion Project is, the more robust the competitive process must be. So, for example, for an unserved community who is seeking a utility to bring service to 5000 potential customers, a rigorous competitive solicitation process, with specific bid criteria and information requirements, should be undertaken. For an unserved community who is seeking a utility to bring service to 50 customers, a simple email seeking expressions of interest sent to a list of potential proponents that are known to be interested in such opportunities may suffice.

4.3.4 The information that should be considered in a competitive process is the most important element. The selection process must be based on key outcomes for customers. The criteria must be focused on costs and rates, as well as in operating a safe and reliable natural gas distribution system. It should not be what is in the best interest of the municipalities.

4.3.5 The Board should require, at a bare *minimum*, the main criteria based on which it chooses the successful proponent, should include the following:

- Forecast capital and operating costs;

- Experience with operating a natural gas distribution system;
- Financial capability; and most importantly; and
- **Forecast rates and rate structure for customers.** [emphasis added]

4.3.6 SEC accepts that these will just be forecasts and the margin of error may be high, but without this crucial information, no competitive process will actually lead to the most appropriate and cost-effective supplier of natural gas to a community.

4.3.7 SEC accepts that it is the municipality who must undertake the competitive process, not the Board. As the Board cannot impose terms of a Franchise Agreement upon a municipality and a utility under the *Municipal Franchise Act*[135], it is not for it to determine the 'winner' of the competitive process and then require both sides to enter into an agreement. But since the Board is not conducting the process, it must set out expectations of what criteria it uses to scrutinize one that has been undertaken, when the successful proponent seeks a Franchise Agreement or Certificate of Public Convenience and Necessity.

4.4 The Board Needs To Take A Proactive Role

4.4.1 If the Board is to require a competitive process, or if one is undertaken, it must ensure that it is done appropriatly. SEC submits it is too late to do that at the first rate-hearing after the assets are already in-service. There are a few regulatory steps that have to be undertaken before a community can be served, and would give the Board an opportunity to review the competitive process.

4.4.2 ***Franchise Agreement Application.*** The Franchise Agreement application approval process is the first step in the regulatory process, is the best time to review the adequacy of the competitive process. The only concern is the scope of the Board's legal authority in these applications which are narrower than in other cases such as rate-making. The Board through still must ensure that the Franchise Agreement still ensure it is in the public interest.

[135] *Municipal Franchises Act*, R.S.O. 1990, c. M.55

4.4.3 The Board has the authority to approve, or not approve, a Franchise Agreement. It does not have the authority to approve only some portions of it or the ability to include provisions it feels are necessary and then impose that on the parties. What it can do under section 9 of the *Municipal Franchise Act* is to impose a conditional approval, i.e. indicate to the parties that it does not accept the proposed agreement, but would accept one if certain terms were included.[136] The Board does also have the authority to attach conditions pursuant to section 23(1) of the *OEB Act*, on any approval order it does make.[137] The Board can ensure that any Franchise Agreement, whose terms do not meet the requirements of a fair competitive process, will not be approved as it is not in the public interest.

4.4.4 On the other hand, the Board may not have the authority to mandate that Franchise Agreement submitted must have been awarded by way of competitive procurement process. It is approving the agreement itself, not the process specifically. Similarly, it does not have the authority to impose binding requirements on what must be included in a Franchise Agreement. To do so would be, in essence, to predetermine the decision it has to make upon an application and fetter its discretion. It can give guidance though, as it regularly does with Board policy, and is the rationale behind the Model Franchise Agreement.[138]

4.4.5 The purpose of a Franchise Agreement has historically been to regulate the interaction between the municipality and the utility, primarily regarding a utility's duties to comply with municipal requirements regarding issues such as occupancy of a gas utility plant in and on municipal roads and rights of way.[139] As it has been referred to in this proceeding, it is the "keys to the kingdom" because it is a necessary condition for a utility to provide natural gas service in a community.

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[136] *MFA* , s.9
[137] *OEB Act*, s.23(1)
[138] *Report of the Board* (EBO 125), May 21 1986 ["*EBO 125*"], para. 6.2-6.3
[139] *Report of the Board* (EBO 125), May 21 1986 ["*EBO 125*"], para. 2.9-2.10

4.4.6 ***Certificate of Public Convenience and Necessity Application***. Equally important to the Franchise Agreement, is the requirement to obtain a Certificate of Public Convenience and Necessity before a utility can construct any distribution infrastructure and supply natural gas to a community pursuant to section 8(2) of the *Municipal Franchise Act.*[140] Unlike leave to construct requirements under the *OEB Act*, which are required for each specific set of proposed facilities, a Certificate of Public Convenience and Necessity is not. Although the test for approvals do have some similarities as the Board stated in EBO 125:

> In dealing with an application for leave to construct a pipeline or for a certificate of public convenience and necessity, the Board must decide whether it is in the public interest that the facilities be constructed. The Board requires the Applicant to identify the least-cost alternative, having regard to relative cost, operational constraints, market access and environmental impact. Other matters that the Board considers include the safety and availability of pipe, security of gas supply, ability to fund the project, construction practices, environmental factors and right of way concerns.[141]

4.4.7 SEC submits that it may be more appropriate for the Board to require that, when it is to make a determination of issuing a Certificate of Public Convenience and Necessity, a competitive process must have been undertaken as a way to test the public interest in awarding the Certificate to the specific applicant for an expansion project. While this would not normally be required, it is appropriate in this case since the project will require existing customers to subsidize the expansion and thus ensuring that the process to determine the proponent is done on a competitive basis. At this juncture, as compared to the Franchise Agreement application processes, issues such as cost of the facilities and the operational capabilities are squarely at issue in the Board's determination.[142] For expansion projects that require leave to construct, the certificate application occurs at the same time if one does not already exist. This has been past practice.[143]

4.4.8 From a practical perspective, it achieves much of the same aims. A municipality that

[140] *MFA*, s.8(2)
[141] *EBO 125*, para. 2.15
[142] *EBO 125*, para. 2.15
[143] For example, Union Gas' expansion to the Red Lake Area EB-2011-0040/EB-2011-0041/EB-2011-0042) and Greenfield Energy Centre Limited Partnership application for approvals necessary to serve its gas fired electricity generation facility (EB-2005-0441/442/443/473)

wants natural gas service will know that the Board will not grant a Certificate of Public Convenience and Necessity to the utility it has entered into, and the utility will know it will not be granted one, unless a competitive process is undertaken. The downside is that this is later in the process and so there is greater risk of wasted funds if the requirements are not clear. Utilities may not want to take part in a competitive process, enter into a Franchise Agreement which would be approved, and only after than find out they would not be awarded a Certificate of Public Convenience and Necessity due to an inadequate competitive process.

4.4.9 ***Subsidy Program Eligibility.*** The Board fan also use the eligibility requirements for any subsidy program (either jurisdiction-wide or intra-utility) as a way to ensure a fair and appropriate competitive selection process was undertaken. Any Board framework can specify that a utility seeking to use existing ratepayers to subside their expansion project can only do so once there is evidence presented that the process to select them was competitive. This conditional approach to existing ratepayer subsidies is even easier if the Board adopts a jurisdiction-wide subsidy model since it would have administrative control over the fund.

5 OTHER ISSUES (ISSUES 7, 12)

5.1 Rate Recovery and Incentive Regulation

5.1.1 Both Enbridge and Union are seeking to have the costs of expansion projects be treated as a Y-Factor and passed through to rates. SEC submits that the current incentive regulation framework for both utilities does not permit this and the Board should reject such a request.

5.1.2 The rate-setting framework for both Enbridge and Union are governed until the end of 2018 by the Board's decision in EB-2012-0459[144], and EB-2013-0202[145] respectively. In the case of Enbridge, it was determined after a full contested hearing, and for Union, the Board accepted a settlement agreement reached by the company and ratepayer groups. The Enbridge IR decision and the approved Union settlement agreement are carefully crafted to balance the needs of the utility with that of ratepayers, and set out when and how rates can be adjusted.

5.1.3 Union's rate framework includes certain specified Y-Factors for certain categories of costs such as DSM, upstream and commodity costs, and potentially most relevant for this proceeding, major capital projects.[146] It also includes provisions for Z-factor for the treatment of unforeseen events.[147] Both the provisions Y-factor for major project capital projects ("Capital Pass-Through Mechanism) and Z-factor have specific criteria that must be met. Union concedes that expenditures from any expansions projects would meet neither the definition of a major capital project or a Z-factor.[148] At a minimum, it admits none of its proposed projects would meet the revenue or capital cost requirements under the Capital Pass-Through Mechanism.[149] Neither does it meet the requirements for a Z-Factor of expenditures beyond the control of the utility's management (it is not required to do these expansion projects), or result, or related, to a type of risk which it cannot

[144] *Decision with Reasons*, (EB-2012-0459 - Enbridge), July 17 2014
[145] EB-2013-0202, Ex. A-1; *Approved in Decision* and Order (EB-2013-0202), October 7, 2013
[146] EB-2013-0202, Ex.A-1, p.26-35
[147] EB-2013-0202, Ex. A-1, p.35-36
[148] Tr.6, p.150-151
[149] JT.1.14

mitigate or is outside the realm of the basic utility undertaking.[150]

5.1.4 At the hearing, Union justified its request by saying "that there is nothing in the IRM framework that prevents us from requesting a new capital pass through mechanism as things change."[151] SEC disagrees. The entire premise of the IRM framework is that it sets a framework for just and reasonable rates for 2014-2018 and includes all the mechanisms where additional amounts can be included. It is not open for a utility to, during the period, ask for amounts to be passed on to ratepayers that do not accord with the IRM framework. To do so would render it open-ended and fundamentally alter how the Board has treated incentive-regulation regimes. As the Board has previously said, "it has an ongoing responsibility to determine whether activities undertaken during the IRM term [were] being characterized in accordance with the IRM Framework".[152] Parties negotiated a full agreement which the Board approved, which includes when items not contemplated could be included, and on what basis the agreement can be determined (off-ramps).

5.1.5 For Enbridge, there is no approved settlement agreement but a decision of the Board which sets out its rate-setting framework for 2014-2018. The EB-2012-0459 decision sets out when costs not included under the rate-setting formula can change and how the framework itself may end (off-ramps). The only mechanism available to Enbridge is a Z-factor for which, like Union, they do not meet the criteria.[153] Enbridge concedes that Z-factor treatment would not be appropriate.[154] Enbridge has taken the position that it's eligible since the costs "were not included in company's incentive regulation application at that time."[155] SEC submits many things were not included in Enbridge's applications, some that benefit customers and some that benefit the utility. The Board's EB-2012-0459 decision explicitly creates the mechanisms that those costs could be considered for inclusion – by way of a Z-Factor. It was open for Enbridge to seek a pass-through

[150] EB-2013-0202, A-1, p.35
[151] Tr.6,p.151
[152] *Decision and Order on Preliminary Issue*, (EB-2012-0087 - Union Gas), November 19 2012, p.25. Cited in *Union Gas Limited v. Ontario Energy Boar*d, 2015 ONCA 453, para. 54
[153] *Decision with Reasons*, (EB-2012-0459 - Enbridge), July 17 2014, p.19-20
[154] S3.EGDI.BOMA.12
[155] Tr.1, p.11

mechanism for any costs not included in its application, but if it had, the Board's decision would have looked different as the risk-reward balance would have had to change dramatically.

5.1.6 Both utility's IRM frameworks, which the Board has determined were just and reasonable, are about the balancing of risks. There may be merit in having a pass-through mechanism for the next IR framework, beginning in 2019. But that is a debate to be had at that time and will be part of a broader rate-setting discussion which encompasses balancing the risks between the utilities and ratepayers specific to applications that are filed. Until then, the utilities are not eligible for any pass-through of expansion costs into rates.

5.2 Grant and Loan Program

5.2.1 Over a year ago, the Government, through the Minister of Economic Development, Employment and Infrastructure, announced a $200M Natural Gas Access Loan program ("Loan Program"), and a $30M Natural Gas Economic Development Grant ("Grant Program") to support the expansion of natural gas to unserved communities.[156] To date, no details have been provided regarding either program. The 2016/17 budget only makes reference to the Loan Program and not the Grant Program.[157]

5.2.2 At the current time, there is no information about either program, except that the Loan program will be interest-free. [158] The Board's task, if it creates a framework, is to ensure that it will lead to just and reasonable rates. The Board must do so assuming there is no grant or loan program.

5.2.3 ***Role in the Economic Feasibility Analysis and Framework.*** If the Government, in the end, uses the grants and loans to help offset costs of projects that fall within the Board's

[156] Minister of Economic Development, Employment and Infrastructure, *Ontario Expanding Natural Gas Service to More Communities*, April 24 2015 <https://news.ontario.ca/medt/en/2015/04/ontario-expanding-natural-gas-service-to-more-communities.html>
[157] Tr.6, p.226-227
[158] Office of the Premier, *Province Expanding Ontario Community Infrastructure Fund, Connecting Links Program*, February 22 2016 <https://news.ontario.ca/opo/en/2016/02/province-expanding-ontario-community-infrastructure-fund-connecting-links-program.html>

framework, then the Board should require the utilities to credit those amounts back to existing customers.

5.2.4 More likely is that the Government will provide the loans and grants to municipalities to expand any Board framework. This would be done by providing the loans and grants to allow for municipalities to get the financing they need to pay CIAC to bring proposed projects that would not meet the PI thresholds, to a level that would allow them to go forward. This approach is what Union appears to favor. [159] It also appears this may be the approach that is likely to be taken by the Government, based on comments the Minister previously made in late 2015.[160] If this is the case then the amounts would be dealt with the same way CIAC are currently dealt with in EBO 188. However, the rate impact limits of the framework would still apply.

5.2.5 ***Optimal Use of the Funds***. Ideally, the Government will use the money in the most optimal way which works in conjunction of any framework the Board issues.

5.2.6 Based on the evidence in this proceeding, the most optimal use for either program is to help reduce the one-time upfront conversion costs that individual customers face switching to natural gas. It is those upfront costs that create, for many, simply a psychological barrier to convert, and causes the payback period issue discussed earlier in these submissions.

5.2.7 The Government could provide direct grants to customers to convert. This would have the added benefit of likely dramatically increasing conversion rates which will improve

[159] Tr.4, p.165; Union Evidence, p.38

[160] EB-2015-0179 B.CCC.16; Transcript, Standing Committee on Estimates, November 17, 2015:

> Hon. Brad Duguid:
> We've made some very serious commitments about providing loan opportunities to help some of those businesses move forward with natural gas expansion. We've got a grant program that we're looking at that can help in that respect as well that we'll be rolling out. It's still going to take some time because the first step had to be taken, and that was a step that the OEB had to take.
>
> Ideally, and if you talk to the sector they understand this, with more flexibility, Union Gas and Enbridge can do more and expand more, and they're willing to do it. The Minister of Energy has provided OEB with those directions, and that is now opening up some opportunities for expansion, so we can now work off of that to determine how much further we can go and where to make those investments. So we're putting together a program.

the individual project PI. It could also provide, through the Loan Program, interest free-loans directly, or through the municipalities, to customers to help them spread the conversion costs over a longer period. It would also allow the Board to have higher expansion surcharges and thus, lower the cross-subsidy (or even eliminate it) if required, from existing customers.

5.2.8 If the Government does use these programs to expand the number of communities that would be eligible under any framework the Board creates, it would be best if those funds were used to maximize the number of customers who could be connected. This means awarding the loans or grants based on which proposed projects do not meet any Board framework and would connect the most customers per dollar granted and/or loaned.

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6 COSTS

6.1.1 SEC hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that SEC has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible.

ALL OF WHICH IS RESPECFULLY SUBMITTED

Original signed by

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Mark Rubenstein
Counsel for the School Energy Coalition

APPENDIX A

Board Issues List	SEC Argument Reference
1. What is considered a community in the context of this proceeding?	2.5
2. Does the OEB have the legal authority to establish a framework whereby the customers of one utility subsidize the expansion undertaken by another distributor into communities that do not have natural gas service?	3.1
3. Based on a premise that the OEB has the legal authority described in Issue #1, what are the merits of this approach? How should these contributions be treated for ratemaking purposes?	3.2-3.3
4. Should the OEB consider exemptions or changes to the EBO 188 guidelines for rural, remote and First Nation community expansion projects? a) Should the OEB consider projects that have a portfolio profitability index (PI) less than 1.0 and individual projects within a portfolio that have a PI lower than 0.8? b) 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. c) What, if any, amendments to the EBO 188 and EBO 134 guidelines would be required as a result of the inclusion of any costs identified above? d) What would be the criteria for the projects/communities that would be eligible for such exemptions? What, if any, other public interest factors should be included as part of this criteria? How are they to be determined? e) Should there be exemptions to certain costs being included in the economic assessment for providing natural gas service to communities that are not served? If so, what are those exemptions and how should the OEB consider them in assessing to approve specific community expansion projects? f) Should the economic, environmental and public interest components in not expanding natural gas service to a specific community be considered? If so how?	2.1.-2.4, 2.9

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? If so, what approaches are appropriate and over what period of time?	2.6-2.8
6. Are there other ratemaking or rate recovery approaches that the OEB should consider?	1.3.5-1.3.6
7. Should the OEB 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 once the assets are used and useful?	5.1
8. Should the OEB consider imposing conditions or making other changes to Municipal Franchise Agreements and Certificates of Public Convenience and Necessity to reduce barriers to natural gas expansion?	4.1-4.4
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 processes and what are the existing barriers to implementation? (e.g. Issuance of Request for Proposals to enter into franchise agreements)	4.1-4.4
10. 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 services in communities that do not currently have access?	2.3-2.4, 2.9
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?	2.3-2.4, 2.9
12. How should the OEB incorporate the Ontario Government's recently announced loan and grant programs into the economic feasibility analysis?	5.2