EB-2016-0004

**THE ONTARIO ENERGY BOARD**

Generic Proceeding on Natural Gas Expansion
in Communities not Served

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# ARGUMENT OF
# EPCOR UTILITIES INC.

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June 20, 2016

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# I. INTRODUCTION

## A. Background to and Objective of the Generic Proceeding

This Generic Proceeding can trace its origins to the Ontario Government's 2013 Long-Term Energy Plan where the Government committed to investigating opportunities to expand natural gas service to communities in Ontario that are not currently served. This initiative became the subject of a February 17, 2015 letter from the Ontario Minister of Energy to the Chair of the Ontario Energy Board (the "Board"). That letter encouraged the Chair to examine opportunities to facilitate access to natural gas service in more communities.

On February 18, 2015, the Board issued a letter to interested parties stating it would consider requests for regulatory flexibility or appropriate exemptions in the context of an application related to specific expansion projects. The Board invited parties with appropriate technical and financial expertise to propose as part of their applications any options that would address regulatory barriers.

The first application in response to the Board's letter was submitted by Union Gas in July 2015 to provide natural gas service in a number of unserved markets. Subsequently, on November 30, 2015, the Board determined that it would be more efficient to consider the various elements of that application in stages. The Board decided to first address the proposed funding mechanisms and consider applications for specific markets later.

Subsequently, the Board, in a letter dated January 20, 2016, advised the parties that it intended to proceed with a generic hearing on its own motion as the issues raised by the parties in the Union Gas proceeding were common to all gas distributors and potential new entrants. The Board stated that a generic proceeding would allow it to establish a common framework to provide guidance to entities that wish to provide gas distribution services across Ontario.

The Board's Procedural Order No. 2 dated March 9, 2016, set out in Schedule B thereto, the Final Issues List, which is specific to issues relating to the expansion of natural gas service in Ontario communities that are currently unserved.

## B. Natural Gas – Challenges, Benefits and Government Initiatives

The shale revolution has led to profound changes in North American natural gas markets.[1] Prices are likely to remain low for the foreseeable future. Flows of natural gas across North American pipeline networks have been fundamentally altered as well, with significant consequences for pipeline owners and users.

At the same time, electricity prices have increased dramatically in Ontario further propelling migration to natural gas.[2] The differential in the cost of heating homes with electricity compared to gas will increase. Currently the cost savings resulting from the switch from electricity heating to gas heating can be two thousand dollars per year or higher. This differential is even greater in the rural and remote parts of Northern Ontario that face colder weather. The ability to bring lower cost energy to these markets is a central factor driving the Ontario natural gas initiative.

Another driving force are the important economic benefits of expansion of natural gas networks: it lowers energy costs for households, farms, and commercial and industrial establishments; access to low cost energy can also spur economic growth in the expansion area; and, there are potentially environmental benefits as natural gas has the lowest carbon footprint in the hydrocarbon family.
Expansion can also lead to higher capacity utilization rates of existing transmission, distribution and storage infrastructure which may lead to broader sharing of costs. Security of supply may also be enhanced if infrastructure is strengthened.

[1] See evidence of A. Yatchew, filed on behalf of EPCOR Utilities, March 21, 2016 http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/521545/view/EPCOR_%20Evidence_Sub_20160321.PDF. Natural gas markets are continental because of the cost of shipping overseas. During the financial crisis beginning in 2008, gas prices dropped dramatically in many parts of the world. However, in the ensuing years North American prices remained low while prices elsewhere recovered. This divergence signaled the fundamental shift stemming from the shale revolution. See e.g., BP Statistical Review of World Energy June 2015, page 27, http://www.bp.com/content/dam/bp/pdf/energy-economics/statistical-review-2015/bp-statistical-review-of-world-energy-2015-full-report.pdf.

[2] The shale revolution also underlies the significant shift in oil markets, the magnitude of which we have not seen since OPEC first exercised its market power in 1973. Extraction of unconventional oil has upturned oil markets not just because it provides a new source of supply, but more importantly because it is *scaleable*. The cost of a shale well is a few million dollars (in comparison to billions for undersea fields). Saudi Arabia, the leading member of OPEC has changed its strategy from supporting market price, to maintaining market share. See, e.g., A. Yatchew (2016), "Discerning Trends in Commodity Prices", forthcoming *Macroeconomic Dynamics.*

In addition to these benefits, the Ontario Government has recognized the increasing divergence of energy costs between areas that enjoy natural gas service and those that do not, the latter usually being in rural areas where incomes are often lower. For these reasons, the Government is promoting natural gas expansion, and supporting it with new loan and grant programs.

The above mentioned 2013 Long-term Energy Plan (LTEP) signaled the Ontario Government's intention to ensure that additional communities would gain access to natural gas in order to benefit from the changing North American market and low prices. The LTEP stated that "[T]he government will work with gas distributors and municipalities to pursue options to expand natural gas infrastructure to service more communities in rural and northern Ontario."[3]

As noted above, in his letter in February 2015, the Minister of Energy encouraged "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".[4] In response, the Board issued a letter to prospective applicants for expansion of natural gas distribution inviting parties to identify options for expanding natural gas services in communities for which the economics of the proposed projects may not be strictly accommodated within the current regulatory construct.[5]

In April 2015, the Ministry of Economic Development, Employment and Infrastructure officially introduced the $200 million Natural Gas Access Loan and $30 million Natural Gas Economic Development Grant program stating that the program "will attract new industry, make commercial transportation and agriculture more affordable, help to create jobs, provide more energy choices and will lower electricity prices for businesses and consumers across Ontario." [6]

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[3] Ontario Ministry of Energy "Achieving Balance, Ontario's Long Term Energy Plan", page 7, http://www.energy.gov.on.ca/en/ltep/achieving-balance-ontarios-long-term-energy-plan/.

[4] Letter from the Minister of Energy, Bob Chiarelli, to Ontario Energy Board Chair, Rosemarie Leclair, February 17 2015, http://www.ontarioenergyboard.ca/oeb/_Documents/Documents/Letter_Minister_to_OEB_Chair_20150217.pdf.

[5] "E.B.O. 188. IN THE MATTER OF the Ontario Energy Board Act, R.S.O. 1990, c. O.13; AND IN THE MATTER OF a hearing to inquire into, hear and determine certain matters relating to natural gas system expansion for The Consumers' Gas Company Ltd., Union Gas Limited and Centra Gas Ontario Inc.", Final Report of the Board, January 30, 1998. Henceforth "EBO 188".

[6] Government of Ontario, News Release, April 24 2015, https://news.ontario.ca/medt/en/2015/04/ontario-expanding-natural-gas-service-to-more-communities.html

## C. EPCOR's Involvement in the Generic Proceeding and Basic Position

The Board's letter of February 18, 2015 invited parties "with the appropriate financial and technical expertise to propose one or more plans for natural gas expansion". EPCOR is such a party. The company is an established utility wholly owned by the City of Edmonton with over $6 billion in assets and electricity transmission and distribution operations in Alberta and water treatment and distribution and wastewater treatment facilities in Alberta, British Columbia, Saskatchewan, Arizona and New Mexico. In late 2015, the company was successful in a competitive bidding process to obtain three natural gas franchises in Ontario and signed those agreements in early 2016.

EPCOR retained Dr. Adonis Yatchew of Charles River Associates and a Professor of Economics at the University of Toronto to address the questions raised in the Board's Issues List for the Generic Proceeding. Dr. Yatchew testified that competitive processes can bring very considerable benefits in terms of reduced costs and a more rapid expansion of natural gas service. He concluded that competitiveness for franchise agreements was in the public interest and should be promoted by the Board.

Dr. Yatchew also testified that Union's proposal regarding the existing customer surcharge (TES) will act as a barrier to entry to new entrants. This charge will raise tens of millions of dollars annually for investment in expansion markets, however, Union insists that these funds should only be available to support Union's expansion projects. Enbridge takes the same position with respect to its projects . It was Dr. Yatchew's evidence that such funds should be available to any utility that qualifies as a distributor in an expansion market.

A summary of the differences between the positions of EPCOR, Union, and Enbridge was outlined by Dr. Yatchew in his oral evidence at Transcript pages 170-173, Thursday May 12, 2016. The Comparison Table at Appendix B sets out the difference, but Dr. Yatchew's view is worth repeating here.

> **What are the main differences between your views and those put forth by Union and Enbridge**?
>
> a. I believe there should be an Expansion Reserve, to which all natural gas customers in the Province would contribute. The Reserve should be administered by the Board and all utilities or proponents should have access to the Reserve on an equal footing.

b. I believe that the Board should promote competition for franchises, and that barriers to entry should be minimized as far as possible.

**How else do your views differ from those of the incumbents?**

a. I do not agree that there are material scale economies that are lost if new entrants, albeit smaller entities, are able to operate franchises in Ontario. Again, the benefits of competition dominate.
b. The utility that wins the franchise is one of the beneficiaries of the expansion and should make a contribution, in some form. The new customers they gain are a valuable asset.
c. Advanced reinforcement charges are a barrier to entry, and should be covered by all customers, not just new ones.
d. Incentive regulation should be in place at the outset of a new franchise. And utilities should not be able to use expansion funds to underwrite losses.
e. Parties should be able to amend the Model Franchise Agreement on a case by case basis. This would potentially include such terms as termination rights, and proposed rate surcharges to customers in expansion areas necessary to finance gas expansion.

**Are there any similarities between your respective positions?**

a. We agree that potential new customers, in areas that are more costly to serve, should pay more for service whether through a surcharge or through higher rates. Higher rates may be an alternative to an aid to construct contribution from the municipality.
b. In order to expand service to new areas, it is not unreasonable for existing customers to make a modest contribution.
c. Capital expenditures become part of rate base as soon the capital is used and useful.

# II. THE BOARD'S JURISDICTION

Issue Number Two in in this proceeding is as follows.

> 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 the communities that do not have natural gas service?

## A. Legislative and Jurisprudential Context

The Board derives its rate-setting jurisdiction from s. 36 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch. B (the "***OEB Act***"), which empowers it to set "just and reasonable" rates. These powers are very broad, expressly providing that the Board "may adopt any method or technique that it considers appropriate",[7] and permitting the inclusion of "conditions, classifications or practices" as they may pertain to all aspects of the gas industry.[8]

The Board's rate-setting jurisdiction has been interpreted "broadly", as extending "well beyond a strict construction of the task",[9] and with emphasis on "the broad purpose of the Act, which is to regulate all aspects of the gas distribution business".[10]

The "rates" that the Board is empowered by s. 36 of the *OEB Act* to set are also broadly defined. The *OEB Act* defines a "rate" to mean "a rate, charge or other consideration and includes a penalty for late payment". The Board has held that "this definition is very broad, and that it appears to cover virtually any payment from a customer to a utility for the provision of distribution service", including costs not included in the approved tariff of rates.[11] The Board has specifically held that customer contributions in aid of construction fall within this definition of a "rate" for the purposes of s. 36 of the *OEB Act*.[12]
The Board is expressly permitted by s. 36(3) of the *OEB Act* to use "any method or technique that it considers appropriate" in fixing rates. This power has been interpreted very broadly, and as being based on the Board's legislated objectives, as made clear in the summary provided by the majority of the

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[7] *OEB Act*, s. 36(3).
[8] *OEB Act*, s. 36(4).
[9] *Toronto Hydro-Electric System Limited v. Ontario Energy Board*, 2010 ONCA 284 at para. 25.
[10] *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2005), 74 O.R. (3d) 147 (C.A.) at para. 28.
[11] EB-2012-0396 (February 7, 2013) at 14.
[12] EB-2012-0396 (February 7, 2013).

Ontario Divisional Court in *Advocacy Centre for Tenants-Ontario v. Ontario Energy Board* ["***ACTO***"]:[13]

*C. The Purpose of the Act and the Reason for the Board's existence*

The objectives for the Board with respect to natural gas regulation are set forth in s. 2 of the Act

(2) The Board, in carrying out its responsibilities under this or any other Act in relation to gas, shall be guided by the following objectives:

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.
4. To facilitate rational development and safe operation of gas storage.
5. To promote energy conservation and energy efficiency in a manner consistent with the policies of the Government of Ontario.

5.1 To facilitate the maintenance of a financially viable gas industry for the transmission, distribution and storage of gas.

6. To promote communication within the gas industry and the education of consumers.

The Divisional Court has emphasized in the past that the Board's mandate to fix just and reasonable rates "is unconditioned by directed criteria and is broad; the board is expressly allowed to adopt any method it considers appropriate." *Natural Resource Gas Ltd. v Ontario Energy Board*, [2005] O.J. No. 1520 at para. 13 (Div. Ct.). The Divisional Court also stated in *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2005), 75 O.R. (3d) 72, [2005] O.J. No. 756 at para.24:

> …[T]he legislation involves economic regulation of energy resources, including setting prices for energy which are fair and reasonable to the distributors and the suppliers, while at the same time are a reasonable cost for the consumer to pay. This will frequently engage the balancing of competing interests, as well as consideration of broad public policy.

Writing for the majority of the Supreme Court of Canada in [*ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, 2006 SCC 4] at para. 62 Bastarache J. stated that "[r]ate regulation serves several aims – sustainability, equity and efficiency – which underlie the reasoning as to how rates are fixed."

[13] (2008), 293 D.L.R. (4th) 684 (Ont. S.C.(D.C.)) at paras. 33-36.

The *ACTO* case is highly relevant to the jurisdictional question currently before the Board. That case concerned an appeal to the Ontario Divisional Court from a decision of the Board (member Kaiser dissenting) that it lacked jurisdiction to approve an Enbridge tariff that effectively caused low-income Enbridge customers to be subsidized by all other Enbridge customers – a specious form of the "cross-subsidization" argument raised by Union and Enbridge in the present proceeding. The argument advanced in favour of this position, then as now, was that such a rate scheme would be contrary to the fundamental "cost of service" approach to utility rate-setting, in particular the "cost causation" principle, pursuant to which consumers pay only those costs associated with serving them. After engaging in a lengthy discussion of the applicable legislation and its purposes (quoted from above), including the history and meaning of the "just and reasonable" standard as it applied to gas distributors in Ontario,[14] the Court concluded that "just and reasonable rates" were those that responded to the Board's statutory and policy objectives, even if that meant a departure from the "traditional" approach to "cost of service" rate-setting, notably including the principle of "cost causation".[15] The jurisdictional issue before the Board in this case is analogous to the issue decided in the *ACTO* decision, insofar as the Board is being asked to determine whether it has jurisdiction to require one group of customers to subsidize another. The only distinction is that in the present case, as opposed to *ACTO*, the customer classes may receive services from different utilities. Clearly, the rationale and conclusions in *ACTO* apply equally to the jurisdictional question currently before the Board; however, the *ACTO* decision has also been cited by other parties (notably Enbridge) in opposition to EPCOR's position. This case is therefore discussed in greater detail in the relevant sections below.

The Board's rate-setting powers must also be interpreted in the light of relevant policy considerations: regulators are not "created with the main purpose of interpreting [their enabling legislation] in the abstract, where no policy consideration is at issue, but rather to ensure that utility rates are always just and reasonable".[16] In *ACTO*, the majority of the Divisional Court noted that the Board is bound by s. 27 of the *OEB Act* to pursue policy statements issued by the Minister.[17] In this case, no formal policy direction has been issued pursuant to ss. 27 or 27.1 of the *OEB Act*; however, the Ontario government has clearly stated its intention to extend service to communities not presently receiving natural gas

[14] *ACTO* at paras. 10-51.
[15] *ACTO* at paras. 52-63.
[16] *ATCO Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board)*, 2006 SCC 4 at para. 30 *per* Bastarache J for the majority, discussing the role of the Alberta Energy and Utilities Board.
[17] *ACTO* at para. 58.

service, which intention was expressly cited by the Board as the basis for commencing this generic proceeding.[18]

There is other clear guidance from the Board itself on the rate-making policy applicable to gas distributors in Ontario, most recently enunciated in its 2005 *Renewed Policy Framework* for natural gas distribution.[19] In that framework, arrived at after extensive consultation with industry participants and other interested parties, the Board interpreted its statutory objectives as requiring a rate-setting regime that met the following criteria:[20]

(a) establish incentives for sustainable efficiency improvements that benefit both customers and shareholders;

(b) ensure appropriate quality of service for customers; and

(c) create an environment that is conducive to investment, to the benefit of both customers and shareholders.

The issue of the Board's jurisdiction to create an Expansion Reserve funded by all industry participants is fundamentally a question of the scope of the Board's rate-setting jurisdiction, and therefore must be approached in these terms.

The Supreme Court has recently stated its position regarding the Board's discretion over its rate-setting methodology in *Ontario (Energy Board) v. Ontario Power Generation Inc.* ["***OPG***"]:[21]

> In judicially reviewing a decision of the Board to allow or disallow payments to a utility, the court's role is to assess whether the Board reasonably determined that a certain payment amount was "just and reasonable" for both the utility and the consumers. Such an approach is consistent with this Court's rate-setting jurisprudence in other regulatory domains in which the regulator is given methodological

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[18] Ontario Energy Board, *Letter to All Applicants and Potential Applicants for Expansion of Natural Gas Distribution* (February 18, 2015) at 1:

> The Provincial Government has set out a goal of ensuring that Ontario consumers in communities that currently do not have access to natural gas are able to share in affordable supplies of natural gas. In an effort to facilitate enhanced access to natural gas for rural and remote communities and businesses in the province, the Ontario Energy Board (the "Board") is inviting parties with the appropriate financial and technical expertise to propose one or more plans for natural gas expansion.
>
> In this context and depending on the nature and scope of any proposals made, the Board is aware that regulatory flexibility may be required. The Board will hear requests for regulatory flexibility or appropriate exemptions in the context of an application made for approvals pertaining to expansion portfolios and specific projects.

[19] Ontario Energy Board, *Natural Gas Regulation in Ontario: A Renewed Policy Framework* (March 30, 2005).

[20] *Ibid.* at 18.

[21] 2015 SCC 44 at para. 81.

discretion, where it has been observed that "[t]he obligation to act is a question of law, but the choice of the method to be adopted is a question of discretion with which, under the statute, no Court of law may interfere": *Bell Canada v. Bell Aliant Regional Communications*, 2009 SCC 40 (CanLII), [2009] 2 S.C.R. 764, at para. 40 (concerning telecommunication rate-setting), quoting *Re General Increase in Freight Rates* (1954), 76 C.R.T.C. 12 (S.C.C.), at p. 13 (concerning railway freight rates). Of course, today this statement must be understood to permit intervention by a court where the exercise of discretion rendered a decision unreasonable. Accordingly, it remains to determine whether the Board's analytical approach to disallowing the costs at issue in this case rendered the Board's decision unreasonable under the "just and reasonable" standard.

The legislation and its policy context, as interpreted by the courts, leave no doubt – on the "reasonableness" standard or any other – that the Board has jurisdiction to create the proposed Expansion Reserve.

## B. The Board has Jurisdiction to Establish the Proposed Expansion Reserve

The majority of the Ontario Divisional Court in *ACTO* held that the Board in selecting a rate-setting methodology is tasked with applying policy, not creating it.[22] However, there is ample justification within s. 2 of the *OEB Act* itself for the proposed Expansion Reserve. The Board's statutory objectives in s. 2 *OEB Act* – by which it "shall be guided" in carrying out its responsibilities relating to gas, including its rate-setting powers under s. 36 – include an exhortation to "protect the interests of consumers", not only with respect to price but also with respect to service quality and reliability. The Board's s. 2 objectives also extend to the "rational expansion" of gas distribution systems and to "facilitating" the maintenance of "viable" distribution systems. By addressing consumers' broader interests in service quality and reliability and the maintenance and expansion of the gas network generally, s. 2 recognizes that the Board must be guided by a big-picture approach to regulation.

The Board has in fact adopted such a big picture approach specific to its rate-setting jurisdiction over gas distribution. Its *Renewed Policy Framework* expressly contemplates the Board's rate-setting policy as a means of improving the gas distribution system *generally*, for the benefit of all ratepayers. Although the *Renewed Policy Framework* discusses changes to rate regulation applicable to individual utilities, the policy basis for these changes is province-wide. The Board expressly draws a link between

[22] *ACTO* at paras. 54-5 6.

sustaining a robust *province-wide* gas market, on the one hand; and benefits to consumers, including price and security of supply, on the other:[23]

> The Board is committed to creating a predictable and stable regulatory environment that encourages continued investment in the sector. A strong, financially viable sector will help to sustain a robust gas market in Ontario, which will benefit consumers in terms of price and security of supply. In the Board's view, while Ontario's natural gas sector does not now suffer from an overall lack of investment, it is important to examine the incentives for investment to ensure they create a stable financial base for the utilities.

The policy context specifically applicable to this proceeding is clearly stated in terms of "ensuring that Ontario consumers in communities that currently do not have access to natural gas are able to share in affordable supplies of natural gas".[24] This objective is not confined to specific distributors, nor does it dictate the rate-setting methodologies that the Board may use in reaching it.

The proposed Expansion Reserve clearly fits within this framework, as outlined in the evidence of Dr. Yatchew on behalf of EPCOR.

Based on the Board's s. 2 objectives and applicable policy, the Board has held that consumers benefit from distant changes to the distribution network that bring lower prices and better service, and that they should pay for those benefits. In its 2013 rates decision *Re Union Gas*,[25] the Board considered a situation where ratepayers on a transmission line upstream of a gas pumping station were obliged to pay the costs associated with the pumping station, even though the pumping station predominantly moved gas off of the transmission line.[26] The Board held that this was permissible, based in part on the fact that the upstream customers benefited from the pumping station: it reduced the size of the facilities required to supply the upstream customers, and, by contributing out-of-franchise revenues to offset in-franchise costs, it reduced the rates payable by the upstream customers. In other words, the Board considered it "just and reasonable" for ratepayers to pay for services located elsewhere on the network

[23] *Renewed Policy Framework* at 19.
[24] Ontario Energy Board, *Letter to All Applicants and Potential Applicants for Expansion of Natural Gas Distribution* (February 18, 2015) at 1.
[25] EB-2011-0210 (October 25, 2012).
[26] *Ibid.* at 70-73.

and not directly related to the costs of serving them, because the benefits derived from those services were considered part of the services "received" by them.

In practical terms, it makes no difference to the customer whether their improved service results from the activities of the distributor that happens to be serving them or from the activities of another utility. To the extent that consumers receive a benefit, it is "just and reasonable" for them to pay for it. The Board therefore has, in s. 36 of the *OEB Act*, express jurisdiction to establish any rate-setting mechanisms necessary to achieve this end.

Union argues that the Board requires "explicit legislative authority" to create the proposed Expansion Reserve.[27] EPCOR responds that the Board's express rate-setting powers, considering the Board's legislated purposes and as interpreted by the courts and by the Board itself, are sufficiently broad to allow it to create the proposed Expansion Reserve, and do not require that the Board have any more "explicit authority" to do so. EPCOR also notes that the legislation contains virtually no "explicit authority" to enact *any* given rate-setting mechanism – including such novel and wide-ranging mechanisms as incentive rate-making ("IRM"), to which Union and Enbridge are currently subject and would surely not object on this basis.

Union also asserts that "explicit legislative authority" is required in this case because the proposed Expansion Reserve would offend the "just and reasonable" principle that is the sole explicit limitation on the Board's rate-setting jurisdiction.[28] Enbridge adopts a similar argument in its submission.[29] The following sections demonstrate that these arguments are unfounded and, indeed, contrary to the applicable legal principles.

## C. Objections Based on the Identity of a Customer's Chosen Service Provider

In the views of both Enbridge and Union, "just and reasonable" rates may only include the costs and benefits provided to a customer by a single utility. There is simply no jurisprudential basis for this position. On the contrary, the Supreme Court's clearest recent interpretation of "just and reasonable" rates takes a holistic view of the allocation of costs and benefits, without regard for the role of any given utility. In its discussion of the regulatory compact – the notional bargain that balances the

[27] Union submission at 3:6-3:11.
[28] Union submission at 3:13-3:15.
[29] Enbridge submission at paras. 5-7.

interests of regulated utilities and ratepayers – the majority in *OPG* characterized "just and reasonable" rates in the following terms:[30]

> In order to ensure that the balance between utilities' and consumers' interests is struck, just and reasonable rates must be those that ensure consumers are paying what the Board expects it to cost to efficiently provide the services they receive, taking account of both operating and capital costs. In that way, consumers may be assured that, overall, they are paying no more than what is necessary for the service they receive, and utilities may be assured of an opportunity to earn a fair return for providing those services.

The majority in *OPG* did not interpret the regulatory compact narrowly, as subsisting between a ratepayer and only those utilities that directly or physically serve it. On the contrary, it approached the compact holistically, in terms of services received by consumers on the one hand, and utilities' provision of those services on the other – *without* distinction based on the existence of a direct contractual relationship between a utility and a consumer.

The majority's characterization of "just and reasonable" rates in holistic terms recognizes that, although the services received by a given consumer *generally* correspond to the services provided by the utility whose bills they pay, yet this is not *always* the case. The fundamental principle underlying "just and reasonable" rates is that consumers should pay for all the services they receive, irrespective of the identity of the utility whose endeavours provide them: the Board's rate-setting jurisdiction under s. 36 therefore must extend to permit this.

Both Union and Enbridge tacitly acknowledge that system expansion results in rate benefits to consumers by their ultimate support for postage-stamp distribution rates. Postage-stamp rates effectively distribute the costs of providing service to all of a utility's customers equally among those customers, with the implication, according to the "cost of service" principle cited by Enbridge and the "benefits follow costs" principle cited by Union, that all customers receive a correspondingly equal share of the benefits (or costs) resulting from changes to the system as a whole, including system expansion.

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[30] *OPG* at para. 20 *per* Rothstein J for the majority (emphasis added).

Given the requirement that "just and reasonable" rates correspond to the costs of providing the services (including the benefits) received by consumers, consumers *cannot* legitimately be excused from paying for services based on the identity of the utility that provides them. Far from supporting the "just and reasonable" principle, Union and Enbridge, by advocating that customers be responsible only for the costs borne by the distributor that happens to supply them, would have the Board violate it.

The argument that utility ratepayers should only pay for those benefits provided by their chosen service provider is therefore founded on an incorrect understanding of the "just and reasonable" rate-setting principle, and on the erroneous factual assumption that the only benefits received by a customer are those provided by the customer's own service provider. Contrary to Union's and Enbridge's arguments, it is clear that the "just and reasonable" principle provides no jurisdictional barrier to the proposed Expansion Reserve.

### D. Objections Based on Rate-Setting Principles

In their evidence, Enbridge and Union also argue that the Board lacks the jurisdiction required to establish the proposed Expansion Reserve based on their contentions that the proposed Expansion Reserve would infringe one or more of several rate-setting principles – namely, "cost of service", "benefits follow costs", and the "standalone" principles – which they consider to inform the "just and reasonable" standard that governs the Board's rate-setting jurisdiction. Enbridge cites the Ontario Divisional Court's analysis in *ACTO* to the effect that the Board, in exercising its discretion under s. 36 in selecting a rate-setting methodology, must act "according to the law" and not for any "extraneous purpose".[31] This mirrors Union's arguments that the legislated "just and reasonable" requirement would be breached by the alleged violation of Union's cited principles.[32]

Legally, however, none of these alleged principles is determinative of the Board's jurisdiction in this context. To begin with, the Board's discretion under s. 36(3) of the *OEB Act* to select its rate-setting methodologies includes the power to modify or disregard even what may be considered by some to be common and frequently-applied rate-setting principles. In the recent *OPG* decision, concerning the Board's rate-setting jurisdiction over electric utilities, involving a similar statutory requirement that the Board be unconstrained in its selection of methodology, a 6-1 majority of the Supreme Court upheld the Board's use of its rate-setting powers to displace the principle that prudent costs should be assessed

[31] Enbridge submission at para. 6.
[32] Union submission at 3:13-4:19.

on a no-hindsight basis. Like the no-hindsight analysis at issue in *OPG*, the "cost of service" principle, like the principles cited by Union, is only one of several rate-setting tools available to the Board, and may be modified or overridden if to do so would result in rates that are "just and reasonable". To the extent that *ACTO* might be read to suggest otherwise, EPCOR submits that it has been superseded by the clear finding of the majority of the Supreme Court in *OPG*.

More fundamentally, however, Enbridge's and Union's positions entirely ignore the uncontroverted fact that overall system expansion and the addition of new gas customers to the system benefits all customers on the overall system. The Expansion Reserve recognizes this fact, and is thus completely consistent with concepts like the "cost of service" and "benefits follow costs" principles. Moreover, Enbridge and Union willingly ignore their cited principles where customers receive a benefit from a utility's activities elsewhere on the system – they call this mechanism "cross-subsidization". In its own evidence, Union itself even recommends such "cross-subsidization" between *its own* existing and potential consumers, and notes that this is common practice for gas transmission projects.[33] However, Union's support for cross-subsidization is myopically (yet predictably) limited to the situation where a consumer's benefit is provided by the *same* utility that serves those consumers. As discussed in the previous section, this interpretation is inconsistent with the concept of "just and reasonable" rates as recently expounded by the Supreme Court in *OPG*, as it introduces an alien link between the ratepayer and their chosen service provider and does not account for benefits received by the ratepayer as a result of developments (such as system expansions) made by other utilities.

Moreover, it is incorrect to say that granting a utility access to subsidy funds which are funded in part by another utility's customers violates any cost of service principle. The funds come from a surcharge on the existing customer's base rates, which base rates cover the existing customers cost of service. The purpose of the surcharge is to fund system expansion in other areas. The funds are not designed to cover the cost of service that Union Enbridge incurs in providing natural gas to its existing customers. Those rates are set in a separate cost of service proceeding. Put differently, the surcharge funds are not revenue, rather, they are an aid to construct. Nor are the surcharge funds being paid to another utility to fund the other utility's cost of service. The existing customer surcharges are strictly for the purpose of contributing to the capital cost of the new assets in expansion markets.

[33] Union submission at 6:19-7:11.

EPCOR also notes that "cost of service" in particular was expressly displaced by the Ontario Legislature as a legislated ratemaking principle in 1998 when it replaced the rate-setting provisions in s. 19 of the *Ontario Energy Board Act*, R.S.O. 1980, c. 332, which more or less prescribed "cost of service" ratemaking, with the current s. 36 of the *OEB Act*, which removes all reference to cost of service and instead expressly invests the Board with discretion to select an appropriate rate-setting methodology. The majority of the Ontario Divisional Court discussed this change in some detail in *ACTO*[34] (cited by Enbridge in its submission). The Court expressly held that the "cost of service" approach is no longer inviolable under the current legislation:[35]

> We agree that the traditional approach of "cost of service" is the root principle underlying the determination of rates by the Board because that is necessary to meet the fundamental, core objective of balancing the interests of all consumers and the natural monopoly utility in rate/price setting.
>
> However, the Board is authorized to employ "any method or technique that it considers appropriate" to fix "just and reasonable rates." Although "cost of service" is necessarily an underlying fundamental factor and starting point to determining rates, the Board must determine what are "just and reasonable rates" within the context of the objectives set forth in s. 2 of the Act. […]

Thus, even prior to *OPG*, the law in Ontario was that the "traditional approach" was not sacrosanct, and that cost of service was only a "starting point" subject to the Board's s. 36(3) discretion as informed by the objectives in s. 2 of the *OEB Act*.

The Board itself has expressly displaced "cost of service" rate-setting by approving IRM schemes for Union and Enbridge, which substitute an incentive scheme under which utilities are expressly *not* guaranteed to recover their costs associated with serving customers, but are also given the opportunity to recover *more* than the amount of those costs.

[34] At paras. 19-24.
[35] *ACTO* at paras. 52-53.

## E. Unjust Discrimination

Union, in its evidence, refers to the Board's recent Guidelines for Transmission Pipeline applications as follows:

> The Board's Filing Guideline on the Economic Tests for Transmission Pipeline Applications (EB-2012-0092) states: *"The Board continues to hold the opinion that it is appropriate for existing customers to subsidize, through higher rates, financially non-sustaining extensions that are in the overall public interest if the subsidy does not cause any undue burden on any individual, group, or class.*[36]

It is Union's position that this opinion should not be limited to transmission pipeline applications. EPCOR agrees. EPCOR also agrees that the proposed surcharge charge of two dollars a month or $24 a year is not an undue burden on existing ratepayers.

In this Generic Proceeding, Union and Enbridge propose that there would be a pool of funds for each utility which would administered and accessed only by that utility. EPCOR proposes that the funds be pooled and administered centrally by the Board and be available to all qualifying utilities.

The difference is important and has important legal consequences. The test for approving rate subsidies to promote system expansion is that the plan must be in the *overall* public interest. The objectives set out in the legislation clearly specify system expansion as an objective, however, the subsidies can only be justified if the plan is designed to promote "the *broad* public interest" not just the interests of a select group.[37] Thus, the Union and Enbridge proposals unjustly discriminate against ratepayers not served by Union or Enbridge and it also unjustly discriminates against EPCOR.

Utilities compete with each other for franchises and, as described elsewhere in this argument, competition is in the public interest. The prohibition on unjust discrimination in monopoly utility rates, a long standing common law principle[38], usually refers to discrimination between customers. However as the court noted in *Challenge*[39] the unjust discrimination principle also prohibits a monopoly utility

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[36] EB-2012-0092, Appendix A, Item 13 (dated February 21, 2013)
[37] *Union Gas Ltd. v. Township of Dawn* (1977) 15 OF (2nd) 722
[38] *St. Lawrence Rendering Company LTD. v. City of Cornwall* (1951) OR 669 at 683; *Attorney General of Canada v. City of Toronto,* 1893 SCR 514
[39] *Challenge Communications Ltd. v. Bell Canada,* Telecom Decision CRTC 77-16 3 CRT 489 (23 December 1977) Aff'd [1979] 1 FC 857, 86 DLR (3d) 351 (C.A. 1978)

from discriminating against a competitor.

EPCOR submits that rates that involve unjust discrimination are neither in the overall or broad public interest nor within the Board's jurisdiction. A rate proposal that discriminates unjustly against a specific group of new customers, a specific municipality, or a specific utility is unjustly discriminatory, unlawful, and should not be approved.

To be clear, there is nothing discriminatory about the rate itself that both Union and Enbridge propose for the existing customer surcharge. And there is no question that setting that rate is within the Board's jurisdiction. EPCOR, Enbridge, and Union all agree on that point. What is discriminatory is the condition that both Union and Enbridge attach to this rate. The condition is that the funds recovered through this rate can only be used by one utility and can only benefit new customers in new markets where the construction is carried out by that utility. That, as outlined earlier, is a discriminatory rate.

EPCOR argues that all utilities should have access to the funds to support construction in any Ontario market. Enbridge argues that the Board has no jurisdiction to do this citing specifically, " in the company's view the Board has no jurisdiction under the governing legislation to make decisions about how funds recovered in rates from customers of a utility are to be allocated to other utilities for the benefit of particular communities not currently served by a distributor"[40].

There is no dispute that the Board in determining whether it has jurisdiction would look first to the objectives in its statue. Two of the Board's objectives are very important in this case. The first objective is to facilitate competition in the sale of gas to user; and the second is to facilitate rationale expansion of transmission and distribution systems. If the Board accepts the condition that both Union and Enbridge propose regarding restricted to access to the funds from existing customers surcharges, it will run directly opposite to these two objectives. This restricted access condition will effectively eliminate competition and new entry, and in so doing will delay and retard rationale expansion of distribution systems.

[40] Enbridge Evidence, EB-2016-0004 page 3 of 36.

## F. Final Points

It might be useful to split the consideration of Issue Number Two into two parts, the first being whether the Board has jurisdiction to set rates in fashion where higher rates in the form of a rate surcharge are placed on existing customers for the purpose of subsidizing the expansion of gas systems in currently unserved markets in Ontario to benefit new customers in those markets.

On this point, it appears that EPCOR is agreement with a number of other parties, most notably Union and Enbridge, namely that the Board does have this jurisdiction. However, Issue Two adds another element to the basic question, namely, can one utility access the customer surcharge funds raised by another utility?

For both aspects, EPCOR submits that it is clearly within the Board's jurisdiction to establish the proposed Expansion Reserve, funded by all gas distribution customers in Ontario, under which ratepayers that receive gas distribution service from one utility contribute to the Expansion Reserve and thus contribute to the cost of facilities constructed by another utility. The only legislative constraint on the Board's discretion to select its rate-setting methodology is that the resulting rates be "just and reasonable", which concept expressly contemplates that consumers pay for the services they receive irrespective of the identity of the utility whose efforts supply those services. The contrary view expressed by Union and Enbridge is based on the erroneous assumption that customers of a given utility benefit only from services provided *by that utility*: in reality, all consumers on an interconnected network benefit, even if only to a small degree, from overall system expansion and the addition of new gas consumers to the system.

The Union and Enbridge positions that funds raised through a surcharge on existing customers cannot be accessed by any other utility is discriminatory in at least three respects.

1. Municipalities who enter into franchises with utilities other than the incumbent utilities will be discriminated against.
2 The citizens of those Municipalities will be discriminated against.
3. Other utilities will be discriminated against

In addition to the legal question regarding jurisdiction, adding the Union/Enbridge restriction would not be good public policy. In determining if a rate proposal is just and reasonable, the Board must also consider a specific question- is the public policy objective set by the government, namely to maximise the expansion of natural gas in the Province, being met?

Adding the Union/Enbridge restriction runs counter to that objective and this restriction will eliminate new utility entry. It will deprive municipalities of a choice in suppliers, which can only promote the expansion of natural gas in rural and remote markets – an important statutory objective in the Board's legislation.

The restriction has serious deficiencies. What if an incumbent collects those funds, but decides not to build? What happens to those funds? Funding mechanisms will better reflect the public interest if the Board determines the priority of projects across the Province as opposed to the two primary incumbent utilities unilaterally selecting those projects.

# III. THE EPCOR APPROACH

EPCOR believes that in order to expand natural gas to rural and remote communities, revisions must be made to the current regulatory framework. In order to assist the Board with developing the revised framework for natural gas expansion, this section will present EPCOR's suggestions for such a framework.

## A. Current System Flaws

There are two apparent flaws in the current system. The first is that the incumbent utilities' response when communities request natural gas supply is to require an aid to construct from the municipality. These amounts are substantial and with very few exceptions the municipality cannot afford the high upfront cost.

An additional flaw is insufficient rate making flexibility. Under a new gas framework, utilities should be able to add long term surcharges in rates to the new customers benefitting from the new expansion project which would in effect raise the necessary aid to construct.

Furthermore, while surcharges have been applied to new residential customers they invariably do not apply to industrial customers. The practice in Ontario has long been that industrial customers are not required to make a contribution as generally the utility is satisfied with a long-term contract. The Board must ensure that all customers are treated fairly and that all customers contribute to the surcharge.

## B. The Expansion Reserve

To achieve the significant benefits of expansion and following the policy direction from the Government, the Board should establish and administer an Expansion Reserve which would be funded by a small volumetric levy on Province-wide sales of natural gas to current customers. System expansion brings direct and indirect benefits throughout the Province.

The maximum potential support from the Expansion Reserve could be based on expected annual sales, averaged over a suitable period. For example, if Project A is expected to generate 10 times the sales volume of Project B, then its maximum support in aid of construction would be 10 times the maximum potentially available for Project B.

This 'per-unit' ceiling would be established in advance by the Board and publicly available. A volumetric based transfer has the appeal that a customer seeking service would be eligible for the same level of support, per unit volume, wherever she or he is located. Unspent or excess funds in the reserve could be returned to customers, based on their contributions, or retained for use in future years.

At the time of approval of the franchise agreement, the Board, which would be ultimately responsible for the distribution of funds, should determine whether the applicant would be eligible for support from the Expansion Reserve. An indication from the Province of the likely magnitude of its financial support would further expedite the development process.

Existing guidelines and principles (in particular EBO 188) assert that current customers should not be subsidizing new customers. The Expansion Reserve would seemingly contravene these rules. However, it should be noted that even current arrangements implicitly contain cross-subsidies of one form or another. For example, under the portfolio approach, customers in areas where the profitability index is above one are presumably cross-subsidizing those with a value less than one.

Furthermore, cost allocations in networks (and more generally whenever there are common costs) do not have unique and unequivocal solutions based purely on principles of cost causality. Some would argue that alternative allocations of costs would be reasonable or even fairer. Indeed, existing customers have likely received a benefit from payments by past customers for infrastructure, for example, in instances where excess capacity was constructed to allow for future growth.

In addition, even existing customers will gain in the longer term from the increase in system customers and sales volumes through reduced unit transmission, distribution, storage and commodity costs. This argument is made by both Union and Enbridge. EPCOR agrees.

To summarize, a modest surcharge on existing customers is, even in the absence of Governmental policy direction, would be within the bounds of equity.

## C. Project Viability

The profitability index[41] of individual projects should continue to provide a useful benchmark as it reflects the costs of an expansion, relative to a measure of revenues. However, a simple specific threshold value, below which projects would not be approved, may not be the best approach, at least not without modification.

There may be communities with industrial or commercial customers who are willing to contribute to expansion costs in order to secure gas supply. In some communities, residential or agricultural customers may be prepared to pay more on the expectation of longer term benefits.

The objective should be for proponents and communities to bring forth a plan which they believe is viable and which incorporates the various sources of funding (including moneys that might be available from the proponent, the Expansion Reserve, the Province, the Municipality, up-front contributions by future customers, and time-limited surcharges within the new franchise). This can be done when applying for a leave to construct. The Board would need to determine whether the plan incorporates reasonable assumptions, is potentially viable, and the mechanism by which any shortfalls would be covered (i.e., how risk is shared).

[41] Under the existing framework, a portfolio of projects may be considered, so long as the overall profitability index meets a specified threshold. To facilitate expansion, the Board may need to consider proposals on an individual project basis.

Such an approach may very well lead to varying rates across new and existing franchise areas. However, this may need to be the new reality and it is noteworthy that there is considerable variation in electricity distribution costs and rates across the Province.

## D. Cost Sharing

It is reasonable that all interested parties make contributions to ensure viability of a project as each will gain from the enterprise:

a. Provincial funds could be earmarked to support conversions. In rural or suburban communities, lower customer density increases 'conversion costs' as service lines traverse longer distances. For some projects, distance from the source of supply comprises the major share of expansion costs.[42] Connecting these communities may be seen by the Province as an infrastructure project, not dissimilar to road development, which promotes economic development.[43] To the extent that customers convert from oil or propane heating, there may be beneficial environmental impacts.

b. Municipalities could contribute to capital costs associated with connecting the community to existing transmission facilities and building out a distribution network. Municipalities stand to benefit from availability of natural gas in government buildings, schools and hospitals. There is also the potential for favourable economic development impacts as lower energy costs may attract industrial and commercial enterprises. The taxes that Ontario gas utilities are required to pay to municipalities can be substantial; they can include both property and pipeline taxes. To attract service it will often be necessary for municipalities to waive those taxes for a period of time.

c. Given the high and divergent costs of available energy sources in comparison to natural gas prices, customers in new franchise areas stand to benefit. They could contribute via time-limited surcharges but these may create a free-rider problem as some may delay conversion until surcharges expire. Longer surcharges or regulated rates that differ from those elsewhere, (i.e. are higher over the longer term because of the greater delivery costs) are an alternative option. These approaches allow distribution of costs over a longer period of time, and thereby reduce the shorter term hurdles to conversion.

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[42] For example, the Kincardine, Tiverton, Paisley, Chesley communities are 87 kilometers from existing facilities. Union Application, Updated Evidence, Filed: 2015-12-14, EB-2015-0179, Exhibit A, Tab 1, Appendix D, page 1.

[43] In the electricity system, costs of incremental transmission facilities are distributed over a wide population of users, not just those that might be directly served by the project.

d. The distributor serving the new franchise area would incur the dominant portion of capital costs, and would likely be allocated the main portion of risk in the event of revenue shortfalls, or cost overruns. At the same time, the company would benefit through the acquisition of new subscribers and energy sales in a regulated environment.

Given the 'lumpiness' of capital expenditures to supply the franchise, rapid conversion is a highly desirable objective. This in turn may inform rate design (as well as Board and Provincial decisions regarding the levels of support). For example, the Board might consider rates that are lower in earlier years to allow new customers to absorb the costs of conversion.[44]

For new entrants, the regulatory cycle would commence once assets are in place and are being used. The regime would likely be some form of incentive regulation. For existing distributors that are in the midst of an IR cycle, expansion costs and revenues would need to be treated separately from ongoing operations until the completion of the cycle, at which time they could be merged for the subsequent period. This approach will ensure that new entrants and incumbents receive comparable regulatory treatment, and that the latter are not inappropriately burdened with additional unplanned expenses in mid-cycle.

## E. Promoting Entry

As further described in Part V, Competition and Barriers to Entry, in order to facilitate expansion into unserved areas, barriers to entry must be minimized and potential entrants should be given unimpeded opportunity to compete for franchise areas.

In addition, EPCOR submits that an opaque environment, where information is difficult to obtain and its reliability uncertain, creates an additional barrier to entry. Keeping in mind that many expansion opportunities are small in size, external candidates are less likely to explore business ventures unless information is readily available. The Board should therefore consider instituting a series of changes to facilitate competitiveness.

A registry of interested proponents and a comprehensive database of franchise agreements should be made available. The Board can determine the information that must be provided publicly while

[44] In other industries, companies seeking to attract customers may offer 'introductory' rates which encourage switching.

ensuring protection of commercially sensitive data. Board approvals should be conditional on the municipality or other governing authority having conducted a process of due diligence. This may be, but does not necessarily need to be a formal competitive process in all instances. Rather, it could be within a range of processes such as a request for information, request for expressions of interest or other processes that demonstrate that a municipality has conducted due diligence.[45]

The franchise approval stage also provides an opportunity for applicants to seek authorization for innovative new services that may be necessary to make service in the expansion territory viable. During this early stage, it would be appropriate for the Board to determine whether the proponent is eligible for support from the Expansion Reserve. Provincial expressions of the magnitude of its contributions would also be most desirable as such support may be necessary to assure the viability of the project.

Flexibility is an essential feature of commercial transactions, particularly as circumstances and opportunities can differ materially from one location to another. Information on the approaching termination of existing agreements should be publicly available.

In the event that a new provider is successful in its application, clear rules should be put in place to ensure that connections and modifications to existing infrastructure are completed in a timely fashion. New entrants will be dependent on the two main incumbents for the foreseeable future for gas supply; they should not be subject to unreasonable costs (such as advance reinforcement costs) or the exercise of market power. The Board may want to consider an expedited process to resolve disputes.[46]

## IV. UNION AND ENBRIDGE PROPOSALS

### A. Union

In July 2015, Union presented the Board with its Community Expansion proposal. The proposal was a response to the Board's initiative to address the Government's desire to expand natural gas distribution

[45] In some instances, it could be that the due diligence process leads to the conclusion that an formal competitive process is not feasible, for example due to the size of the proposed expansion.

[46] In some industries, e.g. telecom, new entrants have at times been given preference by the regulator to promote competition and expansion of services. In the electricity sector, solar and wind have been given priority connection and dispatch for environmental reasons.

systems to currently unserved communities. Union has indicated that its proposal is guided by a set of principles intended to balance the impacts on all affected parties: [47]

1. Customers and municipalities who directly benefit from Community Expansion Projects should contribute to the financial viability of the project.
2. Expansion customer contributions to project feasibility should be commensurate with the savings achieved by switching to natural gas.
3. Moderate cross subsidization from existing customers is acceptable, provided long term rate impacts are reasonable.
4. Natural gas distributors should not be exposed to financial risk related to the incremental new community capital investments.

EPCOR is in broad agreement with the first three principles: our proposal contemplates that potential new customers, municipalities and existing customers contribute to system expansion costs. Competition for the franchise would reveal the willingness of all parties to contribute to the viability of the enterprise.

However, for reasons indicated above, EPCOR believes that natural gas distributors should not be shielded from all financial risks associated with the projects. The allocation of risk should be an outcome of the negotiation process between the distributor and the municipality and may be embedded in the franchise agreement or be built into the business plan at the Leave to Construct stage.

Union has indicated that its proposal is designed to maximize the number of communities to receive natural gas services *without* the use of provincial funding support.[48] It is unclear why support should not be used if available, given the desirability of expanding to currently unserved areas and the likelihood of wider benefits. In EPCOR's view, Provincial support should not only be accepted but should be coordinated with funding from other sources.

As per the Board's request, the Union proposal puts forth options that would require relaxing certain restrictions of EB0 188, in particular the limitation on cross-subsidization. The impacts are to be

[47] Union Application, Updated Evidence, Filed: 2015-12-14, EB-2015-0179, page 6.

[48] Union Application, page 3.

limited to a maximum subsidy charge of $2 per month per customer. These ‘cross-subsidization’ amounts are to be collected and administered by Union.

Contrary to Union’s position, EPCOR suggests that the Expansion Reserve be a province-wide fund that is administered by the Board or its designate, not by one or another distributor. Under EPCOR’s Expansion Reserve, funds would be available to incumbents and to entrants seeking to expand service to new areas, and would therefore help to level the playing field. EPCOR submits that the regulatory review and oversight required for jurisdiction wide cross-subsidization will not be burdensome as compared to internal utility cross-subsidization, as even if funds are collected under internal utility cross-subsidization because the collected funds for internal subsidy will constitute a substantial amount, significant regulatory review and oversight will still be required from the Board.

The purpose of the Reserve that EPCOR has proposed is to defray capital costs. As such the amounts are treated in much the same way as Capital in Aid of Construction, thus reducing the capital amounts that enter into rate base.

## B. The Enbridge Modifications

Enbridge essentially adopts the Union proposal. Like Union, Enbridge agrees that the existing customer surcharge should be a maximum of $24 a year and that the term should be 10 years. Enbridge also agrees with Union that only the natural gas customers in Ontario to be charged this premium are the customers of Union and Enbridge with these charges being placed in separate funds for each utility. Like Union, Enbridge claims that it has exclusive right to use the revenue generated to fund expansions in its territory.

Like Union, Enbridge agrees that new customers should also pay a surcharge and that should be $.23 per cubic meter. There the agreement ends. Union argues that the maximum term for the new customer surcharge should be 10 years, unlike Enbridge who argues it should be 40 years. Union argues that only general service customers should be levied the surcharge but Enbridge argues that all customers must pay. EPCOR agrees with Enbridge on the last two points.

Enbridge recognizes that greater flexibility in the charge to new customers is important to raise the necessary funds to cover the aid to construct required in these expansion markets.

EPCOR agrees that the surcharge to expansion area customers may be the means that has greatest promise to allow for natural gas expansion to unserved markets and the Board should allow utilities greater flexibility in rate making. Utilities and municipalities can of course propose the level of surcharge for the customers in the new expansion territory, which would then need to be approved by the Board.

# V. COMPETITION AND THE BARRIERS TO ENTRY

Given that so many rural, remote and First Nations communities have remained unserved for significant periods despite the presence of two large incumbent gas utilities, it is very important that introduction of new entrants occurs as this will greatly facilitate expansion to communities that do not currently have access to natural gas. Increased competitiveness and the reduction of barriers to entry will enhance this.

The Board recognizes this in the form of Issue 9 on the Board's Issues List set out in the Procedural Order of March 9, 2016, which states: "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?"

## A. Competition

### The Benefits of Competition

In most industries, the presence of multiple suppliers is sufficient to ensure that there is workable or even vigorous *competition in the market;* customers have alternatives, and failure to provide goods or services at reasonable prices leads to losses in sales and profits. In industries with natural monopoly characteristics, such as electricity and gas distribution, competition in the market is not possible, but there is substantial potential for promoting the public interest through *competition for the market itself.* Competitiveness for franchises can help achieve this objective.[49]

[49] The idea that even in natural monopoly industries, competition in the form of franchise bidding, i.e., for the right to serve as a regulated monopoly supplier, can bring significant consumer benefits was noted by Harold Demsetz, "Why Regulate Utilities?" Journal of Law and Economics, 11(1): 55–65, 1968. For a more recent review of the literature, see, e.g., Mark Armstrong and David Sappington, "Regulation, Competition, and Liberalization," Journal of Economic Literature Vol. XLIV (June 2006), pp. 325–366.

Competitiveness for franchises brings significant benefits:

a. Competitive forces are more likely to ensure that new customers are served at lowest cost. They strengthen a potential distributor's incentives to find ways to reduce the capital costs of expansion where possible, with the benefits of these savings being realized by customers through lower rates.

b. Expansion time-frames will likely be accelerated, particularly if negotiated agreements contain milestones to ensure that the proponent builds the facilities in a timely fashion.[50]

c. With multiple firms vying for customers, there are likely to be innovative offerings to secure a deal, such as alternate and lower cost fixed price construction contracts, conversion financing options and alternative approaches to risk sharing.[51]

d. New entrants may bring alternative business models which take advantage of, for example, economies of scope, by providing multiple services. These can bring savings to customers through the sharing of billing service costs and common overheads.[52] There is considerable statistical evidence that multi-utilities can produce significant cost savings.[53] The provision of multiple services by a single entity can also lead to added convenience for customers.

e. One of the most important benefits of competition is that it promotes dynamic efficiency. Open competition will drive innovation and more efficient ways of producing energy services, for example through combined heat and power facilities. [54]

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[50] In Alaska, a new entrant offered a much more aggressive expansion plan than the incumbent, projecting to connect more than six times the number of customers. See discussion below.

[51] As the Maine Public Utilities Commission noted in its approval of Summit Natural Gas's rate plan "SNG will offer a lower cost alternative compared to other fuels, … and will provide up-front financial incentives to customers to help defray the cost to convert to natural gas." See discussion below.

[52] The cities of Kingston and Kitchener offer multiple utility services within single corporate entities, as does EPCOR in Edmonton and other locations.

[53]EPCOR is a good example. The company provides both water and electricity services in a number of markets. Operating gas distribution services in those markets may bring additional economies that could further increase the benefits. In Ontario, earlier work found significant saving at electricity distribution companies that provided water/sewage services. See A. Yatchew 2000, Scale Economies in Electricity Distribution, *Journal of Applied Econometrics*, Vol. 15, 187-210.

[54] The California Public Service Commission has recently authorized the Distributed Energy Resource Service tariff. The utility is permitted to own and operate a combined heat and power (CHP) facility on or near the customer's premises and to provide the output to the customer at a regulated rate. In the northern parts of Ontario where distribution of natural gas is a challenge because of population sparsity, the ability of a gas utility to provide CHP services to municipal institutions such as hospitals and community centers as well as large farms could provide an important revenue stream to the utility and significant cost savings to customers.

**The Experience in Other Jurisdictions**

The Maine Public Utilities Commission ("MPUC") has a "longstanding policy in favor of gas utility competition."[55] It does not grant exclusive gas franchise territories and is even willing to authorize a second utility to serve an area already serviced by a local distribution company. The MPUC has also shown flexibility in the types of rates or pricing models that it is willing to approve. For example, it has approved higher rates in some areas noting that in new expansion areas "the utility is seeking customers who are in no sense 'captives' of the utility – since virtually all can satisfy their energy needs using other fuels but will reduce their energy costs by adding natural gas as a resource – it makes little sense to apply all the traditional metrics for establishing that rates are 'just and reasonable'."[56]

The MPUC has been willing to authorize new entrants to supply natural gas to unserved areas if they can demonstrate (i) a public need for the service, (ii) the technical ability to provide the service; (iii) adequate financial resources to complete the proposed project; and (iv) the ability to provide the service at just and reasonable rates.[57] The initial threshold requirement is a finding that "the entity proposing to become a public utility has a reasonable chance of bringing its project to fruition, but not that it is certain to do so."[58]

This regulatory approach has attracted new distributors to Maine. The MPUC recently approved the entry and eventual expansion of Summit Natural Gas of Maine ("SNG") into previously unserved areas. SNG's business strategy has been to seek opportunities to serve new areas and has offered innovative approaches to pricing including offering pricing structures that include up-front financial incentives to help defray the costs of converting to natural gas and offering 'on-bill' loans to help bridge the gap between upfront costs of conversion and eventual savings from switching to a cheaper fuel source.

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[55] KPMG Report, page 12.

[56] KPMG Report , page 14.

[57] KPMG Report, page 14.

[58] KPMG Report, page 14.

**The Ontario Electricity Experience**

The Board has previously demonstrated some preference for processes that incorporate competitiveness to select a provider for a natural monopoly service. In 2010, the Board published its Framework for Transmission Project Development Plans which set out its policy for new transmission investment in Ontario. [59] In developing this policy, the Board was guided by the objectives of protecting the interests of consumers with respect to price, quality and reliability of electricity supply and facilitating economic efficiency. The Board stated that "The Board believes that economic efficiency will be best pursued by introducing competition in transmission service to the extent possible" and that introducing competition will "lead to better outcomes for the consumer." [60]

The Minister of Energy concurred with the Board's approach when he wrote to the Board Chair in March 2011, requesting that the Board undertake a process to seek the most qualified and cost-effective transmission company to develop the East-West Tie, a 445 km double circuit 230 kV transmission line to be built in Northern Ontario. The Minister's letter stated:

> "The Board's Policy Framework for Transmission Project Development Plans is well suited to apply to the East-West Tie project. Such an approach would allow transmitters to move ahead on development work in a timely manner, encourage new entrants to transmission in Ontario and bring additional resources for project development. It will also support competition in transmission in Ontario to drive economic efficiency for the benefit of ratepayers." [61]

The benefits of competitiveness in a regulated environment became evident in the Board decision of August 7, 2013 regarding the East West Transmission Tie Line project. The Board received six applications for designation and, in the end, selected the Nextbridge partnership, an innovative combination of two major utilities, NextEra Energy (a major Florida utility) and Enbridge. The third partner was Borealis Infrastructure, an investment arm of the OMERS pension plan. [62] [63]

[59] EB-2010-0059 Board Policy: Framework for Transmission Development Plans, April 26, 2010.

[60] EB-2010-0059 Board Policy: Framework for Transmission Development Plans, April 26, 2010.
[61] See http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/322660/view/
[62] NextEra operates Florida Light and Power, one of the largest rate regulated utilities in the United States with close to five million customers. OMERS is one of Canada's largest pension funds with net assets exceeding $70 billion.

Importantly, the project demonstrated the unique range of capital that can be attracted through competitiveness. Competitiveness is widely recognized as good public policy that generates alternatives and injects market discipline.

**The Southern Bruce Experience**

The benefits of competitiveness for municipal franchise agreements are also well demonstrated by the experience of three municipalities in Southern Bruce County. The Mayors of the three municipalities [64] filed evidence with the Board on March 21, 2016 [65] which described the background and the process in some detail.

*The Process*

The three Southern Bruce Municipalities have long desired to bring natural gas distribution to their areas, however, no existing utility was willing to build there due to prohibitive costs.

One of the Municipalities, Kincardine, entered into a Memorandum of Understanding with Union Gas to develop a detailed load analysis, conduct customer telephone surveys to determine project economics for expanding natural gas to the Municipalities and assessing aid to construct charges that the Municipalities and its customers could face to commence work on expanding natural gas services to their area. Union Gas prepared and completed its report to the Municipalities in March 2012.

Union estimated that the capital expenditures for the project would be close to $97 million and that the resultant required contributions in aid of construction (CIAC) to be paid by the Municipalities would be just under $86 million (based on forecast 2012 costs).

In 2012, another entity, Northern Cross advanced a different approach for gas expansion which would proposed the formation of a new, standalone gas distributor owned by the Municipalities. Under this

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[63] Competitive processes for transmission projects have also been adopted in Alberta and for renewable electricity generation in Ontario.

[64] Mayor Anne Eadie, Municipality of Kincardine; Mayor Paul Eagleson, Municipality of Arran-Elderslie; Mayor Mitch Twolan, Township of Huron-Kinloss

[65] South Bruce_Municipalities Report_20160322 "The approach & competitive solicitation process undertaken by the Municipalities to facilitate the expansion of Natural Gas services to Southern Bruce County."

approach the total costs of the project would be passed on to consumers. However, financial projections using the Northern Cross proposal along with other assumptions showed that rates to be charged to consumers would be substantially higher than those charged by Union or NRG, another natural gas distribution company of similar size and location to that being proposed for Southern Bruce.

In 2014 the Municipalities prepared a further Business Case which considered the Union and Northern proposals and also assessed the technical and economic feasibility of the proposals in light of existing Ontario regulatory requirements and a more recent customer survey and load forecast (demand) information.

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

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

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

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

*The Benefits*

The evidence of the municipalities of Southern Bruce County was that they experienced substantial benefits from increased competitiveness which they summarized at pages 9-11 of their evidence, as follows:

- **An opportunity for alternatives.** Initially the Municipalities were constrained to information being provided by the only gas distributor in the region. Introducing greater competition facilitated other interested parties to provide alternative views on meeting the region's natural gas needs. The participants brought different experiences and approaches to their solution of problems and did so within the framework of a competitive process.
- **Understanding the local energy market.** Through the submissions of the participants the Municipalities improved their understanding of the size and composition of the potential market for natural gas in Southern Bruce. With this came more accurate estimates of the possibilities for savings in energy costs by various customer classes. Equally important was the additional information provided on impediments to conversion to natural gas that could undermine project economics. Recommendations were also given on measures to overcome them.
- **The System Design and Cost.** The participants provided alternative approaches to system design and staging and the links between these elements and market development. In this competitive environment, they also provided alternative views on capital cost estimates which resulted in a significant reduction from the initial estimates. All of these, of course, are critical to project viability.
- **Customer Rates Estimates.** The estimated rates differed significantly between Union and the other participants in the process. In the case of Union, the utility was constrained to charge existing (postage stamp) rates to new customers and the Municipalities would have had to make up for the resulting non-economic nature of the project via a CIAC. Other participants viewed the project as stand-alone and determined the rates required to make it economically viable. This provided a better understanding of the scope for allocating expansion costs to those benefitting directly from the project via rates higher than current Union rates in the broader area.
- **The Role of Subsidies.** The information provided the Municipalities with a better understanding of the role that subsidies might play, whether originating with government

programs or other consumers, and their potential magnitude. Different views were expressed on how any such subsidies would be used.

- **Evaluating Ownership Options.** The initial proposals for expansion were limited to two municipal ownership options, either none or all. The RFI process resulted in a range of ownership possibilities. With competition and more alternatives, each of the three Municipalities could also individually decide on the preferred level of ownership after consideration of likely rewards and risks.
- **Understanding the Regulatory Restrictions.** The competitive process clarified the nature of the regulatory restrictions that impeded the expansion of natural gas markets. The stand-alone option provided more flexibility in the determination of rates which allowed consumers to realize energy cost savings while paying higher rates, at least initially, than surrounding communities.

*Final Points*

The evidence of the Southern Bruce Municipalities is essentially that competition for a Municipal Franchise Agreement is an invaluable instrument in understanding the issues and attracting natural gas distributors to communities not being served.

EPCOR submits that while every community is unique and different circumstances call for different measures, competitiveness, generally speaking is a crucial aspect to expanding natural gas to communities that are presently served. In keeping with this, EPCOR submits that specific amendments to the Model Form Franchise Agreement are not needed, however, Ontario Municipalities should be free to negotiate agreements on a case-by-case basis that meets the needs of local conditions.

To be clear, however, EPCOR submits that competitiveness does not require a formal competitive process, for example an RFI or RFP, in all instances, but rather the creation of a competitive environment where there is an even playing field for all utilities and appropriate exploration of alternatives by Municipalities. A crucial aspect of this is that large, incumbent utilities do not have an advantage over small or new entrant utilities by virtue of, for example, a subsidy fund that only the large, incumbent utilities have access to.

Competition for natural gas franchises in Ontario is in the public interest and the Board should remove any barriers to that. In particular, the Board should resist any proposal that would provide financial support to only the two dominant suppliers.

## B. Barriers to Entry

One of the Board's objectives in this Generic Proceeding is to identify any barriers to entry to natural gas distribution in Ontario and remove them. However, through its application and evidence, Union and Enbridge have suggested a number of new measures that will act as barriers to entry, thus preventing new entrants from entering Ontario to provide service in expansion markets. This, in EPCOR's submission, runs counter to the public policy objectives in this proceeding.

**Discriminatory Rate Conditions**

The first and most significant barrier to entry is the discriminatory rate condition that both Union and Enbridge propose related to the existing customer surcharge. This has been described in detail in the earlier section and does not need to be repeated here. It is, however, a condition that is unnecessary and will prevent entry of new suppliers and the construction of new gas systems.

**Reinforcement Costs**

Another barrier to entry proposed by Union is the imposition of "advancement of reinforcement" charges. In its evidence and at this Generic Proceeding, Union purported that these charges were first allowed in the Board's 1997 decision for the Port Elgin-Southampton-Wiarton expansion Project, and subsequent Owen Sound Line reinforcement.[66] Based on EPCOR's reviews of relevant jurisprudence and Union's submissions in this proceeding, the principles from this decision have not been used since 1997.[67]

In ongoing negotiations between EPCOR and Union for the connection of EPCOR's proposed pipeline for the Southern Bruce municipalities to Union's gas distribution system, Union has informed EPCOR that Union will charge EPCOR $4.2 million in advancement of reinforcement costs.[68] In this Generic

[66] E.B.L.O. 259, 1997.
[67] Union IRR Response to CCC filed April 22, 2016, Exhibit S15.Union.CCC.4
[68] A letter dated April 21, 2016 from Union Gas to a consultant of EPCOR outlining this charge is attached as Appendix A and was filed as an exhibit at the hearing, see http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/529059/view/ .

Proceeding, Union has asked the Board to in principle approve its charge of advancement of reinforcement costs. It is worth noting that through interrogatory response, EPCOR has confirmed that Enbridge does not charge such costs.[69]

EPCOR believes that the imposition of an advancement of reinforcement cost by Union is overly prohibitive and will serve as a significant barrier to entry for any potential entrants into the Ontario gas market. In its review of the Port Elgin decision, EPCOR is unable to determine whether the Board fully authorized all future advancement of reinforcement costs. Moreover, throughout this Generic Proceeding, in an effort to understand the rationale and authority for such charges, EPCOR has requested Union provide a break down for the $6 million charged to the municipality in Port Elgin for the advancement of reinforcement costs. Union has been unable to provide EPCOR with a clear answer on this question and it remains unclear as to whether the $6 million collected from the municipality went towards the advancement of reinforcement costs.

EPCOR holds the position that charges for advancement of reinforcement costs are barriers to entry as the charge is not based on an actual cost but rather a hypothetical cost that may or may not be realized in the future. EPCOR believes it is overly prohibitive for this charge to be placed on a new entrant that is using existing line capacity and not requiring additional capacity. EPCOR submits that advancement of reinforcement charges should be prohibited and EPCOR further submits that the advancement of reinforcement charges should be system charges – that is to say, the cost responsibility for these charges should be borne all of the customers using the system.

EPCOR's expert witness, Dr. Yatchew, cautioned the Board that new entrants will be dependent on the two large incumbent gas distributors for gas supply. Generally, an incumbent has a self-interest in ensuring a competitor does not enter its market. In order for new entrants to enter the Ontario gas market, new entrants must not be subject to artificial gas supply charges from incumbents. The Board should reject the concept of an advanced reinforcement charge and further stipulate that all reinforcement charges should be system charges.

**Distributor Requirements – Timing and Experience**

[69] EB-2016-0004, Exhibit S3. EGDI. EPCOR 2,page 1[70] EB-2005-0441 January 6, 2006.

Union has also proposed that a new entrant must have demonstrated experience as a natural gas local distribution company in order to obtain franchise approval and a CPCN. Union's proposed requirement serves as an additional barrier to entry which EPCOR submits has no precedent and is not needed.

CPCN's qualifications have been considered by the Board on a number of occasions. The two most recent and relevant decisions are *Greenfield Energy Center*[70] in 2006 and *Greenfield South Power*[71] in 2015.

In *GreenField Energy Center*, the applicant filed a leave to construct application for a natural gas pipeline to supply a gas-fired generating station. The applicant had previously obtained a 20 year clean energy supply contract with the Ontario Power Authority and following this, Union filed an application to build a similar pipeline to the same generating station. The Board combined the two competing applications.

In the combined proceeding, the question of competency arose and the Board determined that Greenfield was qualified as it was an experienced developer in a number of jurisdictions.

This issue of applicant qualification was also considered by the Board in the *GreenField South Energy* decision which related to an application by Greenfield South for connection to the Vector pipeline, a high-pressure pipeline extending from Joliet Illinois to Dawn Ontario.

The Board granted the CPCN to Greenfield. The Board reviewed Greenfield's qualifications and held that there was no evidence to support Union's view that Greenfield was not a competent operator or builder of pipeline facilities. The decision is important as it outlines the technical, engineering, and financial capabilities the Board expects of any applicant. The Board did not require the applicant to have existing local gas distribution facilities.

EPCOR submits that the Board's current decisions provide sufficient guidance regarding the qualification of CPCN applicants. There is no need to extend the criteria in the manner proposed by

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[70] EB-2005-0441 January 6, 2006.
[71] EB-2014-0299 April 2, 2015.

Union particularly in light of the objective of reducing barriers to entry and facilitating expansion to unserved areas.

**New Rate Filings**

An additional barrier to entry proposed by Union is that rates must be filed at the time of a franchise application. At page 27 of its evidence, Union states that: "where a pre-existing Board approved rate schedule is not available this would mean that as a necessity the Board must approve rates before the franchise can be approved or delay the franchise approval until such times as the rates are approved by the Board."[72] For an incumbent gas provider like Union, which has postage stamp rates providing rates during a franchise application is possible. However, for a new entrant, without postage stamp rates, determining these rates at the franchise application stage is not possible and, in any event, as noted herein, EPCOR does not believe that postage stamp rates are appropriate in the case of expansion areas.

The introduction of such a timing requirement would effectively bar any new entrant from obtaining franchise approval and there is no precedent for this. Moreover, the logical time for consideration of rates is at or after the leave to construct. Without accurate costs from the leave to construct application, neither the Board nor anyone else will have the cost numbers necessary to set meaningful rates. In fact in previous decisions the Board has said that rates are not within the scope of a franchise hearing.[73]

Indeed, the Board has not in the past required applicants for franchise agreements to seek approval of rates nor is it necessary. No distributor can supply natural gas without Board approved rates. The rate payer is at all times protected. There is no need to turn a franchise hearing into a rate hearing.

Given the above, EPCOR contends that Union's proposed requirement imposes a needless regulatory burden that effectively prevents competition with new entrants in the Province.

## VI. NEW RATE MAKING CONCEPTS

[72] EB-2016-0004, Exhibit A. Tab.1. page 27 of 38.
[73] EB-2012-0072, December 13, 2012.

Much of this proceeding has been devoted to an examination of the proposed funding from existing customers. As described above EPCOR supports that initiative subject to certain important parameters, the most important being that the funds are available to all gas distributors providing service in expansion markets.

However, EPCOR also believes that other new ratemaking initiatives relating to the new customers in expansion territories would be useful in facilitating expansion and that the Board should be open to innovative ratemaking in those markets.

## A. New Customer Surcharges

Union has proposed a new customer surcharge term of 10 years. Enbridge has proposed a 40 year term. EPCOR agrees with a longer term proposal as it may allow the community being served to raise the equivalent of the aid to construct that the utility usually requires. This is particularly the case if the Board determines that industrial customers should make a fair contribution.

There are numerous reasons why natural gas has not expanded into many rural and remote markets in Ontario. One such reason is that the larger utilities with their substantial rate and customer bases have little incentive to move into more costly rural and remote markets. In contrast, new entrants may be more aggressive and innovative in their approach to create the market to the benefit of both the utility and its rate payers.

Also, as expansion markets tend to be more costly, gas utilities often ask the municipalities to contribute aid to construct funds; however, this is problematic as most municipalities simply do not have the means to finance such large expenditures. The result is that too often the discussions end there and the expansion never commences.

Accordingly, to help solve this issue, EPCOR proposes the Board consider innovative ratemaking possibilities, such as allowing a surcharge over a longer term to be paid by all new customers. It is important that the surcharge be paid by all customers and not just the residential customers, as the expansion benefits all customers. In Board Staff Interrogatory 8, Board Staff asked Dr. Yatchew the following question: Will the expansion charge to existing customers be applicable to all customer classes, residential, commercial, industrial, and contract? Dr. Yatchew's answer was yes. EPCOR

contends that this same principle should also apply to the surcharge on new customers in expansion markets – all customers should pay the same volumetric surcharge.

## B. Bundled Rates

The Board should consider allowing utilities in expansion markets to offer customers an alternative rate structure that includes the cost of the equipment necessary to convert the customer to natural gas. This is standard procedure in many industries. The cell phone industry would not exist without bundled rates. Bundled rates could potentially assist rapid conversion in expansion markets.

## C. Incentive Regulation

## D. EPCOR believes that the new regulatory framework relating to expansion markets should continue to employ incentive regulation as the basic ratemaking model from the outset. This has proven to be a successful methodology in Ontario. EPCOR contends that the reason Union and Enbridge believe this principle should not immediately apply to expansion markets is that they wish to shift all the risk in these markets to the customer.[74] EPCOR does not believe that is in the public interest. Moreover it is not necessary. In the EPCOR model each project must have a Profitability Index of 1 once all subsidies and additional funding are taken into account. In these circumstances, the utility should be able to manage the business within the usual incentive rate making principles. LNG Cost Allowance

Enbridge argues that many rural markets are served more cost-effectively by trucking LNG as opposed to building new pipelines. In the *Hagar* decision[75] in 2014 the Board ruled that this activity is an unregulated activity. However, as EPCOR understands it, Enbridge is not proposing that LNG assets be placed in rate base, rather, that the LNG supply is simply a different means of transporting natural gas from one place to the other. In other words, it is an alternative to the construction of gas transmission mains. The cost of LNG supply could be recovered from all customers in the same manner as recovery of the cost of transmission mains. EPCOR supports this approach as it may be a lower-cost alternative for serving rural and remote markets

**[74] One of the principles guiding Union's proposal is that "Natural gas distributors should not be exposed to financial risk related to the incremental new community capital investments. See Union Filed: 2015-12-14 EB-2015-0179 Exhibit A Tab 1 UPDATED Page 6 of 47. Similarly, when asked if ratepayers have to bear all the risks of the expansion projects under the Enbridge Proposal, Mr. McGill said "Well, I guess. I stand by what we said in the interrogatory response to this Parkland question is that, you know, the company is not proposing that it takes on any risk beyond the risks that it has today." See Transcript_REVISED_Generic Volume 1_May 5 2016_20160509 page 208, line 27.**

**[75] EB-2014-0012. April 9, 2015**

## E. The Capital Pass-through

Both Enbridge and Union propose an automatic pass-through of capital cost to rate base once the capital becomes used and useful. This principle was developed in Union's recent IRM settlement agreement[76]. In that proceeding, Union proposed significant new capital expenditures. Union wanted to ensure that the capital, once declared used and useful, would be placed in rate base and the company would not have to wait until rebasing at the end of the IRM period.

Union quite rightly argues that the need for the expansion market investment was unknown at the time Union's IRM framework was approved. The new investment is clearly material given the $150 million in new rate base investment required. Union states that its proposals are the first step in a broader program. Union notes that the objective of the capital pass-through mechanism is to allow the utility to earn its allowed rate of return (no more or no less) during the incentive regulation term. EPCOR agrees. It is important that this principle apply in expansion markets. There is more than enough risk facing utilities in expansion markets without the additional risk of not being able to pass-through capital cost to rate base once the assets are used and useful.

## F. Conversion Risk

The most significant risk in natural gas expansion projects is the rate of conversion. Union states that, assuming current price comparisons to other forms of energy continue, it is likely that attachment rates will climb from around 45% to close to 90% for homes and businesses adjacent to the new systems in the 11 to 25 year period after a project is put in service. The Enbridge customer forecast is based on the assumption that 75% of existing homes and businesses will convert to natural gas over 10 years.[77] This assumption was based on customer surveys conducted in Fenelon Falls and Bobcaygeon on behalf of Enbridge by a third-party market research firm.[78] However, Enbridge also notes that the only expansion project that the company undertook in the last 10 years, Alfred and Planatagenet in Eastern Ontario in 2008, saw customer attachments fall below the anticipated level. The leave to construct application associated with that project was based on the projected addition of 2,376 customers and the in-service date for the project was October 30, 2008. Since that time only 1,382 customers connected to the facilities.[79]

[76] EB-2013-0202, October 7, 2013.
[77] EB-2016-004. Exhibit S3. EGDI. SEC. 17. Page 1
[78] Ibid.
[79].EB-2016-0004. Exhibit S3. EGDI. BOMA. 26. Page 1

Both the Union and Enbridge expansion proposals have virtually all risk being borne by the customer. EPCOR does not believe this is appropriate. EPCOR believes utilities can bear some of the risks of conversion as long as those risks are clearly defined and do not endanger the financial health of the utility.

At the same time at EPCOR believes that there should be ratemaking flexibility that would allow the utility to guard against unlimited conversion risk. This will benefit all investors whether those investors are existing customers, new customers, municipalities, or governments.

## VII. CO-ORDINATING FUNDING

As customer funding is a central issue at hand in the generic proceeding, the discussion to this point has largely focused on funding from existing and new customers. However, the coordination of this funding from the various sources including municipalities and the government also needs to be explored.

In this section, EPCOR shares its preliminary perspectives of possible funding sources that are likely to be available.

### A. Contribution by Utilities

On expansion projects, there is a degree of risk, which largely relates to the demand forecast that partially turns on projected converted rates. If conversion rates are lower than expected, the utility will likely incur loss. Utilities can propose mitigation measures by sharing some of the risks associated with expansions.

While the evidence of Union and Enbridge suggests they require a guarantee against any loss by having the funds contributed from existing customers treated as revenue, EPCOR contends that funds contributed by existing customers should instead be treated as an aid to construct. EPCOR submits that funds contributed by existing customers should not be used to allow the utility to earn a rate of return on funds it did not provide.

## B. Contributions by the Municipality

EPCOR believes that municipalities should contribute to the cost of providing service in expansion territories which could come in the form of tax rebates given by a municipality to the gas distributor of an amount equal to the new property taxes that the expansion project would yield to the municipality over time. EPCOR believes these tax rebates should be negotiated between the distributor and the municipality and included in the franchise agreement. The terms should be flexible and could be as long as the term of the new customer surcharge.

## C. Contributions by the Province

The Province of Ontario has committed $200 million in loans and $30 million in grants to support the expansion of natural gas in the Province. Such contributions are likely to be critical to the viability of many expansion projects and should be used to support construction costs.

The eligibility for those funds may be determined at the time of the franchise hearing or the Leave to Construct application. The actual distribution of the funds may be deferred until after the Board approves the leave to construct application when a more complete business plan with scope, risk, and financial outcomes is in place.

## D. The Approval Process

An effective program to bring natural gas to the rural and remote markets of Ontario will necessarily involve amendments to the current regulatory process. In making these submissions EPCOR assumes that the Board will conclude that all natural gas distributors in Ontario should have access to funds raised from existing customers. EPCOR also assumes that the Board will determine that all funds collected from existing customers will be deposited with the Board and administered by the Board.

The funding process necessarily involves two calculations. The first is the quantum of funding available to a particular expansion market. The second is how that amount is to be obtained from the different funding sources.

Virtually every expansion market will require an aid to construct. One approach is to assume that this amount could be obtained from the three funding sources with a view to improve the probability of success and optimize the impact on the rate payers. The first is the revenue from existing customers which in the EPCOR terminology is called the Expansion Reserve. The second is the funding from the

surcharge paid by the new customers which EPCOR calls the New Customer Surcharge (NCS). The third source of funding is the money that may be made available from the Province which by and large is proposed to be in form of an interest free loan.

The utility seeking funding would as part of its business plan calculate the necessary aid to construct which would be reviewed by the Board as part of the Leave to Construct or a standalone application in advance of the Leave to Construct application. That amount may be determined by the demand forecast and conversion rates in the market in addition to the capital cost of the project.

In the case of the Expansion Reserve (which EPCOR believes the Board should administer) those payments can be directed by the Board to the applicable utility making the application. In the case of the NCS, the utility, in cooperation with the municipality, will determine prior to the application, the surcharge rate and term necessary to generate the required funds, which would then be subject to Board approval.

EPCOR submits that the Board in its decision in this Generic Proceeding should assume that there will be provincial funding and will be expected to play a role to coordinate that funding with the funding from other sources to ensure it is applied to provide an optimized benefit to all stakeholders. While EPCOR recognizes the procedure relating to government funding will ultimately be decided by the Province, EPCOR contends that it is important that the Board provide the critical coordination between public funding and ratepayer funding.

The first step relates to applications by the utility wishing to construct new facilities in expansion markets. In response to that application the Board should determine the utility's eligibility for funding and the quantum. This determination may be made at a time when a complete business plan is in place to allow the Board to understand the overall impact of such funding. This could be done at the Leave to Construct stage or earlier as a special standalone hearing when the utility is in a position to present its business plan.

## VIII. CLIMATE CHANGE REGULATION

Issue 10 on the Board's Issues List set out in the Procedural Order of March 9, 2016, states, "How will the Ontario Government's propose cap and trade program impact an alternative framework that the OEB may establish to facilitate the provision of natural gas serve in communities that do not currently have access? " On May 25, 2016 the Board issued a Staff Discussion Paper on the proposed framework.

The Government is instituting a carbon pricing approach in the form of cap-and-trade to deal with the environmental externalities of hydrocarbon use. This represents an important shift from previous efforts to decarbonize the Ontario economy. Unlike programs such as feed-in-tariffs, which require the Government to select technologies and determine prices, cap-and-trade addresses the adverse externality directly, and permits individuals, firms and markets to determine the most cost effective ways to reduce their dependence on fossil fuels.[80] This in turn promotes equalization of carbon abatement costs across the various uses and users of hydrocarbons in the economy.

At the same time, the Government is proposing to use the funds raised from cap-and-trade permits to subsidize various programs which support decarbonization of the transportation, commercial, residential, industrial and agricultural sectors. (Ontario's Five Year Climate Change Action Plan 2016-2020, released June 8 2016.)

From an environmental perspective, natural gas (methane) has both advantages and disadvantages. It is a hydrocarbon, so its use produces greenhouse gases. On the other hand, methane has the lowest combustion carbon footprint in the hydrocarbon family -- about half that of coal, two thirds that of oil and about 80% that of propane.[81] Furthermore, piped natural gas produces less $CO_2$ than propane (or

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[80] For a theoretical analysis of tools for decarbonization see R. Green and A. Yatchew (2012) "Support Schemes for Renewable Energy: An Economic Analysis", *Economics of Energy & Environmental Policy*, 1, 83-98. For a recent evaluation of renewable electricity programs in Ontario, see B. Rivard and A. Yatchew (2016), "Integration of Renewables into the Ontario Electricity System", forthcoming, *The Energy Journal*.

[81] See U.S. Energy Information Administration, "How much carbon dioxide is produced when different fuels are burned?" https://www.eia.gov/tools/faqs/faq.cfm?id=73&t=11. Some have argued that natural gas is the 'bridge fuel' that will help bring us out of the hydrocarbon age as humans strive to decarbonize their energy production. See e.g., MIT Energy Initiative, "The Future of Natural Gas", http://mitei.mit.edu/publications/reports-studies/future-natural-gas.

oil) delivered by truck because of lower transportation related emissions. Households that switch from oil or even propane heating are therefore expected to be reducing their greenhouse gas emissions.

Electric heating is expensive, and propane and oil heating costs were not much lower prior to the shift in oil markets. The precipitous drop in oil prices is likely to lead to sustained lower oil and propane heating costs, slowing a price induced switch from these heating fuels. However, at the same time that price attractiveness of natural gas can lead to fuel switching and an increase in demand, decarbonization measures may dampen demand growth and even reduce it.

For purposes of the present discussion, the important point is that Government policies which price carbon provide an effective mechanism for capping *total carbon generation* in the Province and ensuring that hydrocarbons, mainly oil and natural gas, are dedicated to their best and most needed uses. Carbon pricing does not preclude, and indeed may promote increased use of natural gas in some sectors at the same time that hydrocarbon use in other sectors declines.

To summarize, expansion of gas services has important economic benefits, it puts rural customers (residential, farm, commercial and industrial) on an energy footing that is closer to that enjoyed by customers in served areas, and it has the clear support of the Government. There are also potential environmental benefits.

# IX. BOARD ISSUES LIST

Board Procedural Decision and Order No. 2, EB-2016-0004 dated March 9, 2016, includes an Issues List. This section summarizes EPCOR's position on each of the issues.

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

   **A strict and narrow definition of "community" is neither necessary nor desirable if the objectives of rational natural gas expansion are to be achieved in the Province. In most cases significant expansion will require franchise agreements with local governing authorities that represent the interests of a specific population and well-defined geographic area. It should be at the discretion of the proponents to put forth the details of the target community. We note that the Province has not provided a specific definition of a community, though the term is used in its letters and documents.**

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?

   **It is clearly within the Board's jurisdiction to establish the proposed Expansion Reserve, funded by all gas distribution customers in Ontario, under which ratepayers that receive gas distribution service from one utility contribute to the Expansion Reserve and thus contribute to the cost of facilities constructed by another utility. The only legislative constraint on the Board's discretion to select its rate-setting methodology is that the resulting rates be "just and reasonable", which concept expressly contemplates that consumers pay for the services they receive irrespective of the identity of the utility whose efforts supply those services. The contrary view expressed by Union and Enbridge is based on the erroneous assumption that customers of a given utility benefit only from services provided *by that utility*: in reality, all consumers on an interconnected network benefit, even if only to a small degree, from overall system expansion and the addition of new gas consumers to the system.**

3. Based on a premise that the OEB has the legal authority described in Issue #2, what are the merits of this approach? How should these contributions be treated for ratemaking purposes?

**Under the existing guidelines in EBO 188, a utility can expand its service to some customers at the expense of others. An individual project may have a profitability index below 1 so long as it is part of a portfolio of projects for which the collective profitability index exceeds 1. However, this arrangement represents a barrier to entry for potential new service providers, thwarting competition 'for the market'.**

**Therefore, following the policy direction from the Government, and in order to support expansion, the Board should establish and administer an Expansion Reserve which would be funded by a small volumetric levy on Province-wide sales of natural gas to current customers. The requirement that current customers make a small contribution to system expansion is within the bounds of equity. Many current customers may have benefitted from contributions made by previous customers. Cost allocations in networks (and more generally whenever there are common costs) do not have unique and unequivocal solutions based purely on principles of cost causality.**

**Furthermore, higher utilization rates of common transmission, distribution and storage infrastructure would lead to broader sharing of costs. There are also economic benefits if access to low cost energy spurs growth in the expansion area; and, there are potentially environmental benefits.**

**Contributions from the Expansion Reserve should not enter into the rate base, but instead be treated as a Contribution in Aid of Construction.**

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?

**In an increasingly competitive environment, it makes sense to move away from a portfolio approach, and from predetermined profitability index thresholds. Instead, parties should assemble a proposal which combines Provincial support, potential transfers from the Expansion Reserve, as well as contributions from the utility, municipalities and customers.**

**The costs of expansion into unserved areas are influenced to a large degree by the distance from existing sources of supply, capacity at the source, and the density of the customer base. These locational and density factors may rationally lead to higher service rates. The viability of a project would depend in part on the willingness of customers to pay potentially higher rates, the willingness of applicants to serve and absorb some of the costs, and the willingness of the Province and municipality or other local government to contribute. In determining its level of financial support, the Province may choose to consider other factors, such as the potential for economic development and other public interest considerations. From the perspective of the Board, it would appear that the Province has communicated its desire for expansion.**

**Implementation could proceed along the following lines: (see Exhibit S4.EPCOR.Board Staff.8, Page 15 of 93).**

1. **The Board would determine an appropriate volumetric levy to be applied to all natural gas customers. As an upper bound, the Board may consider a magnitude similar to that proposed by Union in its application which represents an increase of about $3 to $4 per year for a residential customer consuming 2,200 $m^3$ per year in Union South. This in turn suggests a levy of about $0.0023 per $m^3$.**
2. **All natural gas distributors would recover the levy from their customers through a new charge code identified on the customer's monthly bill. The funds would be transferred to an Expansion Reserve account administered by the Board.**
3. **Once a prospective distributor reaches a franchise agreement with a municipality, it would apply to the Board for franchise approval. At that time, or shortly after that, the distributor could seek confirmation of eligibility to receive funds from the Expansion Reserve.**
4. **The prospective distributor would be eligible for a contribution from the Expansion Reserve if:**
    i. **it met the normal Board criteria for approval of a franchise, certificate of public convenience and leave to construct;**
    ii. **it demonstrated a Profitability Index of 1 for the expansion project, calculated recognizing Government grants and loans, contributions from the municipality, customers and the utility, contributions from the Expansion Reserve, and revenues from future natural gas sales.**
5. **Any funds collected from the Expansion Reserve would be treated as a 'Contribution in Aid of Construction'. The distributor would not earn a regulated rate of return on these funds.**
6. **The term of the Expansion Reserve could be set at 10 years, with a Board review after 5 years. If and when the Board decides to terminate the Reserve, the funds would be redistributed to ratepayers.**

5. Should the OEB allow existing 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?

**Surcharges from customers of new communities of short or medium term duration constitute one option, but they may create a free-rider problem as some potential customers might delay conversion until surcharges expire.**

**Long term surcharges, such as the 40-year ones proposed by Enbridge, or simply higher regulated rates, as proposed by EPCOR, would be preferable as they would distribute costs over an extended period of time, thereby reducing hurdles to conversion.**

**In this connection, distributors should have the flexibility to offer bundled rates which combine gas costs with utility based financing of capital costs of conversion to natural gas, in particular the purchase of boilers or furnaces. This billing model is common in the telecom industry where customers routinely purchase smart phones as part of a service plan with low up-front charges.**

6. Are there other ratemaking or rate recovery approaches that the OEB should consider?

**Given the 'lumpiness' of capital expenditures to supply the franchise, rapid conversion is a highly desirable objective. This in turn may inform rate design (as well as Board and Provincial decisions regarding the levels of support). For example, the Board might consider rates that are lower in earlier years to allow new customers to absorb the costs of conversion.**

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?

**For new entrants, the regulatory cycle would commence once assets are in place and are being used. The regime would likely be some form of incentive regulation. For existing distributors that are in the midst of an incentive regulation cycle, expansion costs and revenues would need to be treated separately from ongoing operations until the completion of the cycle, at which time they could be merged for the subsequent period. However, this**

**interim separate treatment should be within an incentive regulation framework, rather than under a cost of service approach.**

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?

   **Specific amendments to the Model Form Franchise Agreement are not needed, however, Ontario Municipalities should be free to negotiate agreements on a case-by-case basis that meets the needs of local conditions. Flexibility is an essential feature of commercial transactions, particularly as circumstances and opportunities can differ materially from one location to another. Information on the approaching termination of existing agreements should be publicly available.**

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)

   **The Board should maintain a registry of interested proponents and a comprehensive database of franchise agreements should be made available. (The Board can determine the information that must be publicly available while ensuring protection of commercially sensitive data.) Board approvals should be conditional on the municipality or other governing authority having conducted a process of due diligence. This may be, but does not necessarily need to be an 'RFP' process. The franchise approval process could also be used by applicants to seek approval for innovative new services that may be necessary to make service in the expansion territory viable. During this early stage, it would be appropriate for the Board to determine whether the proponent is eligible for support from the Expansion Reserve.**

   **It is essential that barriers to entry be removed or minimized. Advanced reinforcement charges should be prohibited; contributions from existing customers should be collected in a separate fund, the Expansion Reserve, and administered by the Board; and connection by new entrants to existing facilities should occur in a timely fashion. Union and Enbridge's**

**proposed new requirements for the granting of franchise approval and CPCN's would create additional barriers to entry and should be rejected.**

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?

    **A clear distinction should be maintained between cap and trade, and efficient use of energy resources. Government policies which price carbon provide an effective mechanism for capping total carbon generation in the Province and ensuring that hydrocarbons, mainly oil and natural gas, are dedicated to their best and most needed uses. Carbon pricing does not preclude, and indeed may promote increased use of natural gas in some sectors at the same time that hydrocarbon use in other sectors declines.**

    **Furthermore, the Ontario Energy Board, in a separate proceeding, EB-2015-0063, is reviewing the implementation of cap-and-trade within the Ontario gas sector.**

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?

    **The impact on estimated savings and impacts on conversion rates will depend on the relative price changes of competing fuels. While a price on carbon can be expected to increase the commodity price of hydrocarbons, natural gas has the lowest carbon footprint and should therefore merit a lower carbon price on a BTU basis relative to other carbon fuels. The differential between natural gas prices and electricity prices, is likely to remain large. Furthermore, the production price of natural gas is expected to remain at low levels for the foreseeable future.**

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

    **It will be up to the Government to determine the timing, criteria and levels of support. A clear indication from the Government, in a timely fashion, would permit the applicant to incorporate specific numbers into its submissions to the Board for its evaluation and approval.**

## X. CONCLUDING SUBMISSIONS

It is in the public interest to create a competitive environment for system expansion, one that fosters alternative business models, promotes dynamic efficiency and allows communities and municipalities to have broader options for energy supply. Divergence in energy prices has exacerbated energy cost differentials between areas supplied by natural gas, and those presently unserved. Promoting competition will require that barriers to entry be eliminated or minimized to the extent possible.

In Ontario, electricity prices continue to rise, which creates additional pressure for lower cost energy alternatives, particularly in rural areas. In these markets, expansion of natural gas systems can assist and promote the competitiveness of industry and agriculture.

The allocation of costs in networks does not generally admit unique assignments based on cost causality. A range of outcomes can satisfy principles of equity. Furthermore, current Board-approved principles implicitly recognize a degree of cross-subsidization between customers.

The Union and Enbridge proposals support cross-subsidization by existing customers to support expansion. We agree. However, to promote competitiveness and thus expansion, such funds should be available to any company seeking to provide distribution to unserved areas. The Board should therefore establish and administer an Expansion Reserve funded by a small volumetric levy on Province-wide sales of natural gas.

Expansion to new areas can be expensive and all parties – the Province, the municipality or other local governing body, customers and the prospective distributor – have a role in contributing to project viability. Accelerated rates of conversion should be a key objective as once supply infrastructure is put in place, underutilization would represent an economic loss.

The key submissions of EPCOR in this Argument can be summarized as follows.

1. **Funding from Existing Customers.**

   EPCOR supports the concept of funding from existing customers provided that:

   a. it is a standard volumetric charge that does not exceed two dollars per month per customer;
   b. all customers contribute to the fund;

c. all utilities that hold a franchise agreement in an expansion market should be eligible to receive funds from this funding;
d. eligibility and amount of funding should be determined at the franchise hearing;
e. the funds should be administered by the Board in the form of an Expansion Reserve;
f. the funds should be treated as an aid to construct and not included in rate base; and
g. the funds should not be used to cover utility losses in an expansion market.

**2. Funding from New Customers.**

EPCOR supports the concept of funding from new customers provided that:

a. the base rate should be set on the basis of the cost of serving the expansion market not on the basis of an existing postage stamp rate;
b. the maximum term for any new customer surcharge should be 40 years;
c. all customers in the expansion area should pay any new customer surcharge on the same volumetric basis;
d. the serving utility may offer a bundled rate which includes the capital cost of the equipment necessary for conversion; the permitted interest rate implicit in the bundled rate should be no greater than the generic cost of capital proposed by OEB for the utility with appropriate additional adjustments.

**3. Municipal Contributions**

Municipalities should contribute to the cost of providing service in expansion territories. That contribution should come in the form of tax rebates or holidays to be negotiated on a case-by-case basis.

**4. Utility Contributions**

The utility that wins the franchise is one of the beneficiaries of the expansion and should make a contribution, in some form. The new customers they gain represent a valuable asset. That contribution can be made in several ways but one practical way is the assumption of certain risks associated with providing service in expansion markets. Utility innovations in construction, rate designs, risk assumptions, etc. will transpire if the market was opened to additional entrants.

**5. Reinforcement Costs**

Advanced reinforcement charges are a barrier to entry. Such charges should be recovered as system charges from all customers at the time that they are required. One of the guideposts of industry regulation is the idea that, to the extent possible, regulation should elicit outcomes and treatments that would occur if the industry were competitive. It is difficult to imagine that a competitive entity, with new customers at its door, would charge them for facilities that may (or may not) need to be constructed at some future date to serve the customer pool at some future time

**6. Provincial Funding**

Provincial funding is at the discretion of the Government. However, in order to reduce planning uncertainty, it would be highly beneficial if eligibility and magnitude of support from the Expansion Reserve were determined at the time of the an appropriate proceeding within the OEB application process vis-à-vis at either the CPCN, a Leave to Construct, or a special hearing on project funding coordination if the government funds have been allocated.

**7. Franchise fees**

The Board should allow Municipalities in expansion markets to negotiate franchise fees where those Municipalities provide tax holidays to utilities constructing facilities in expansion markets.

**8. Franchise Competitiveness**

The Board should promote competitiveness for franchise agreements including a requirement that Municipalities issue a Public Notice when seeking provision of service, or considering a franchise renewal. The Board should allow flexibility in the kinds of franchise agreements that would be acceptable. Due diligence and decision making responsibilities properly reside with municipalities and proponents.

**9. Franchise Data Base**

The Board should maintain a current public data base on its website disclosing all franchises granted, their start and end dates, and whether facilities have been constructed.

**10. Regulatory Issues**

The Board should allow automatic pass-through of all capital costs to rate base once the capital is used and useful. In addition, the Board should allow utilities to allocate to rate base, the amount of capital contribution to customer owned equipment. For example the Board may allow a Distributed Energy Resource Service (DERS) tariff to recover capital costs related to Combined Heat and Power investments for specific large customers.

Incentive regulation should be in place at the outset of provision of services. Utilities should not be able to use expansion funds to underwrite shortfalls or losses. An essential feature of incentive regulation is that the utility bears a degree of risk, and this feature should apply in the expansion setting to ensure that the utility not only minimizes its capital costs, but implements a business plan which ensures optimal conversion rates.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

DATED AT Toronto, June 20,2016

________________________________________

Gordon E. Kaiser, Counsel for EPCOR Utilities Inc.

## Appendix A: EXHIBIT NO. K7.1: LETTER DATED APRIL 21ST, 2016 FROM UNION TO MR. WOLNIK AT EPCOR.

K7.1

April 21, 2016

Mr. John Wolnik
EPCOR Utilities Inc.
2000 – 10423 101 St NW.
Edmonton, Alberta
T5H 0E8

**Re: South Bruce Project: Initial Project Economics**

Dear Mr. Wolnik,

Union Gas Limited ("Union") has completed the initial project economics for the South Bruce Project.

The South Bruce Project, as defined by EPCOR, is based on the request for Union to provide 10,900 cubic meters per hour ("m3/hour") of distribution service at a pressure of 300 pounds per square inch ("psi"). The identified load will come off at Dornoch directly from Union's NPS 10" main pipeline. This service is based on the natural gas loads confirmed and agreed to by EPCOR and Union on November 17, 2015.

The review of the requirements to service the gas load has been completed and the forecasted estimate of costs was communicated to EPCOR as follows:

**South Bruce Project Total Costs - Order of Magnitude Estimate (+50%/-25%)**

| | |
|---|---|
| Customer Station | 1,200,000 |
| Revenue Requirement – Advancement of Reinforcement | 4,200,000 |
| | **$ 5,400,000** |

The project economics are based on the following input assumptions:

- Contracted Demand: 218,000 cubic meters ("m3")
- Minimum Annual Volume: 31,828,000 m3
- Estimated Annual Volume: 38,485,000 m3
- Distribution Service Rate Class: M9
- In Service Date: December 1, 2017

- Economics were calculated using a 10 year and 20 year contract term
- 100% of the volumes assumed to occur on December 2017 with no graduated volume.
- Volumes will continue at the same level for the entire assumed length of the M9 distribution service contract.

Based on the results of a 10 year contract term, the required aid prior to construction is estimated to be $3,000,000. For a 20 year contract term, the required aid prior to construction is estimated to be $1,000,000. The contract term required to eliminate any aid required prior to construction would be 28 years.

If there are any questions regarding the project economics please do not hesitate to contact me directly.

Yours truly,

Patrick Boyer
Manager, Greenhouse, REM & Wholesale Markets
Union Gas Limited

## Appendix B: COMPARISON TABLE

| PROPOSAL | UNION | ENBRIDGE | EPCOR |
|---|---|---|---|
| Existing Customer Surcharge -- Rate | Max. $24/year | Max. $24/year | Max. $24/year |
| Existing Customer Surcharge -- Term | 10 years | 10 years | 10 years |
| Existing Customers Charged | All Union Customers | All Enbridge Customers | All Natural Gas Customers |
| Administration | Union | Enbridge | OEB |
| | | | |
| New Customer Surcharge -- Rate | $0.23/m$^3$ | $0.23/m$^3$ | +/- * 0.23 cents/m$^3$ |
| New Customer Surcharge -- Term | Max. 10 years | Max. 40 years | Min 10 yrs. Max.40 yrs. |
| New Customers Charged | General Service Only | All | All |
| Treatment of Surcharge | Revenue | Revenue | CIAC |
| | | | |
| Minimum Profitability Index | 0.4 | < 0.4 | 1.0 (Target) |
| Base Rates | Postage Stamp | Postage Stamp | Cost of Service |
| Incentive Rate Making | No | No | Yes |
| Expansion Risk Shared by Utility | No | No | Yes |
| IRM Capital Pass Through | Yes | Yes | Yes |
| LNG Cost Allowance | Yes | Yes | Yes |
| Advance Reinforcement Costs Paid by Entrant | Yes | No | No |
| | | | |
| Bundled Rate Offerings Incorporating Conversion Costs | No | No | Yes |
| | | | |
| Government Contribution | No | No | Yes |
| Government Contribution -- Amount | NA | NA | Sufficient to achieve PI of 1 after inclusion of surcharges |
| | | | |
| Municipal Contribution | ITE | ITE | Tax Rebate |

*To be set to achieve a PI=1.0