June 20, 2016

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
P.O. Box 2319
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

RE: EB-2016-0004 – Final Submissions of the Consumers Council of Canada – Natural Gas Community Expansion – Generic Proceeding

Please find, attached, the Final Submissions of the Consumers Council of Canada in the above-referenced proceeding.

Yours truly,

Julie E. Girvan

Julie E. Girvan

CC:

All Parties
Michael Buonaguro, Counsel
Ken Whitehurst, Consumers Council of Canada

SUBMISSIONS OF THE CONSUMERS COUNCIL OF CANADA

RE: NATURAL GAS COMMUNITY EXPANSION – GENERIC PROCEEDING

EB-2016-0004

June 20, 2016

INTRODUCTION:

1. On February 5, 2016, the Ontario Energy Board ("Board" or "OEB") issued a Notice of Hearing for a generic proceeding to consider potential alternative approaches to recover the costs of expanding natural gas service to communities that are currently not served.

2. Included in the Notice was a draft Issues List which broadly defined the scope of the proceeding and identified issues that the Board was prepared to consider in the context of the proceeding. The Board finalized the Issues List on March 9, 2016, after considering comments on the draft list from parties to the proceeding.

3. The OEB held an oral hearing for seven days over the period May 15, 2016, to May 13, 2016. At the end of the hearing the Board indicated its intent to provide for two rounds of submissions from parties and that it would provide further guidance on the substance of those submissions that would best inform the Board panel.

4. On May 30, 2016, the Board established a schedule for the submissions and expanded the scope of some of the issues set out in the approved Issues List. The Board also decided to proceed with the submission phase of the proceeding despite some requests for a delay pending the release of the Government of Ontario's Climate Change Action Plan. The Climate Change Action Plan was released on June 8, 2016.

5. These are the final submissions of the Consumers Council of Canada (the "Council"). The Council will first provide a summary of its overall positions regarding alternative approaches to community expansion. We will then set out the background and context for the Board's consideration of these issues. The Council will also review its concerns and issues with the proposals being advanced by Union Gas Limited Inc. ("Union") and Enbridge Gas Distribution Inc. ("EGD"). Finally, we will provide submissions regarding each of the issues set out in the Board's approved Issues List.

SUMMARY OF SUBMISSIONS:

I. The Council continues to support the fundamental objective of the EBO 188 Guidelines that existing customers should be held harmless from the cost of providing service to new customers;

II. The Council respectfully submits that those that directly and materially benefit from natural gas expansion are the ones that should fund expansion;

III. Any explicit subsidies for projects that would otherwise be uneconomic should be funded through the province's general revenue and not by existing natural gas customers. If the Government of Ontario is making an explicit policy choice to expand natural gas, that policy should be funded through the tax base;

IV. The utilities' claims that the impacts of their expansions projects on existing customers would be small and not undue does not justify the introduction of explicit cross-subsidies through EBO 188 exemptions;

V. The OEB should not be establishing pre-determined criteria by which a utility can provide a subsidy to new customers from existing customers. Instead the Board should be focusing on permitting regulatory flexibility that will allow for new customers to fund their own expansions.

VI. Expansion to many un-served communities can be facilitated by introducing regulatory flexibility for the utilities that is consistent with the principle of cost causality;

VII. The utilities should be permitted to apply for approval of expansion related surcharges to facilitate the recovery of the expansion costs from the new customers served by the expansion, with the size and duration of the surcharge being determined based on the specifics of the proposed project economics;

VIII. Amending the current discounted cash flow (DCF) analysis as proposed by Union, as well as permitting distributors to establish project specific rates when appropriate will also support further expansion.

BACKGROUND:

Establishing the Generic Proceeding:

6. As part of its Long Term Energy Plan ("LTEP") released in December 2013, the Ontario Government made a commitment to work with gas distributors and municipalities to pursue options to expand natural gas infrastructure to service more communities in rural and northern Ontario. On February 17, 2015, the

Minister of Energy wrote to the Chair of the OEB regarding natural gas expansion. The specific request set out in that letter was the following:

> I am writing to you today to encourage the Board to continue to move forward on a timely basis on its plans to examine opportunities to facilitate access to natural gas services to more communities, and to reiterate the government's commitment to that objective. I appreciate your continued support to ensure the rational expansion of the natural gas transmission and distribution system for all Ontarians.[1]

7. At no point leading up to this proceeding has the Government of Ontario asked the OEB to establish a framework that would have existing customers subsidize the expansion of natural gas service to new communities. The only reference to subsidies in the context of the Minister's statements regarding system expansion is to the proposed Provincial Loan and Grant Program. In 2014 the Ontario Government announced its intent to establish a $230 million loan and grant program to bring natural gas service to underserved communities. This would be funded through the provincial government's general revenue.

8. On February 18, 2015, the OEB released a letter inviting parties with the appropriate financial and technical expertise to propose one or more plans for natural gas expansion. In that letter the Board referred to its 1998 Report, *EBO 188 Report on Natural Gas Distribution System Expansion* (the "EBO 188 Guidelines"). EBO 188 establishes the guidelines for the expansion of natural gas service currently in place today. The Board noted in that letter that the intent of the EBO 188 Guidelines is to facilitate the expansion of natural gas service while holding other customers harmless from the cost of new connections. The Board also stated:

> While minimizing cross-subsidization either within a portfolio of projects, or between a portfolio and the rest of Ontario customers remains an important goal, the Board is cognizant that the specific requirements of EBO 188 may require some flexibility to expand natural gas for communities that are not currently served.
>
> To the extent that the economics of a proposed project may not be accommodated within the current regulatory construct, the Board invites proponents to identify, within their applications, any options to address such regulatory issues. The Board will then consider any such options as part of an adjudicative process. For instance the Board may consider specific and supportable proposals that address:
>
> - Whether the Board should allow existing natural gas distributors to establish surcharges to improve feasibility of potential expansion projects by minimizing the level of required capital contribution;
>
> - Whether the Board should allow for recovery of the revenue requirement associated with expansion costs in rates prior to the end of any incentive regulation plan term once the assets are used and useful;

[1] (Letter from Minister Chiarelli to Chair and CEO Rosemarie Leclair dated February 17, 2015)

- Whether projects that have a portfolio PI of less than 1.0 and individual projects within a portfolio that have a PI lower than .8 should be considered.[2]

9. On July 23, 2015, Union applied for approval of community expansion proposals in response to the OEB's invitation. During the initial steps of that proceeding the Board made a decision to initiate a generic process to establish a common framework and provide guidance to all entities that wish to provide distribution services in communities across Ontario. Although the Board has indicated its intent to consider flexibility within the context of the EBO 188 Guidelines, there has been no explicit direction from the Board that subsidies from existing customers are appropriate or required to facilitate natural gas expansion into un-served communities.

Climate Change Action Plan/Cap and Trade:

10. On June 8, 2016, the Ontario Government released its Climate Change Action Plan (the "CCAP"). The overall intent of the CCAP is to reduce greenhouse gas emissions and move to a prosperous low-carbon economy.

11. Through Bill 172, the *Climate Change and Low-Carbon Economy Act, 2016,* passed on February 25, 2016, and regulations released on May 18, 206 the Ontario Government is establishing a Cap and Trade program. The program is expected to be in place on January 1, 2017.

12. In the evidence it filed in support of its original application Union pointed out that there is an inconsistency between the Ontario Government's desire to expand natural gas service, which will increase natural gas use, and the implementation of a Cap and Trade Program which is designed to compel reductions in natural gas consumption in order to reduce carbon emissions. Union's position is that the ultimate degree to which any approved regulatory flexibility is used will depend upon reconciling these two opposing government policy positions.[3]

13. The Government has launched its cap and trade program and is moving ahead with a number of other initiatives as part of the CCAP that may impact the natural gas sector (promotion of geothermal and renewables in Aboriginal communities, subsidies for electricity etc.) and its viability going forward. This should, from the Council's perspective, dissuade the Board from establishing a framework that facilitates natural gas expansion that is not economic and places a number of risks on existing natural gas ratepayers. With uncertainty around the use of carbon-

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[2] Letter from Peter Fraser, Vice President, Industry Operation Performance to All Applicants and Potential Applicants for Expansion of Natural Gas Distribution, dated February 18, 2016.
[3] EB-2015-0179, Ex. A/T1/p. 1

based fuels in the future, those risks could significantly increase for the existing natural gas customer base.

UNION'S PROPOSALS:

14. Union has proposed a framework that would expand natural gas service to 33 communities (29 projects) at a capital cost of $135 million and serving approximately 18,500 customers. The proposed subsidy from existing customers, under Union's proposals, if approved, would be approximately $68 million. The projected benefits to the new customers would be approximately $313 million.[4]

15. The major components of Union's proposals are:

    a) A Temporary Expansion Surcharge ("TES") of $.23/m3 to be collected over the period of time required to reach an approved minimum Profitability Index ("PI"), subject to a maximum of 10 years;
    b) An Incremental Tax Equivalent ("ITE") to be paid by municipalities based on the estimated value of the incremental property taxes collected from Union over the same period as the TES;
    c) A Temporary Connection Surcharge ("TCS") for smaller main extension projects that do not meet Union's proposed definition of a community project;
    d) An exemption from the EBO 188 Guidelines that would allow community expansion projects that achieve a minimum PI of .4 to proceed with a Contribution in Aid of Construction (a "CIAC");
    e) An exemption from the EBO 188 Guidelines requirement that these new community expansion projects be included in the Investment Portfolio and the Rolling Project portfolio;
    f) A capital pass-though mechanism to recover the costs of the new expansion as they come into service (Ex. A/T1/pp. 1-31, EB-2015-0179).

Analysis of Unions' Proposed Projects:

16. In the Council's view the rational expansion of natural gas service to many areas of Ontario can be facilitated through only a few modifications to the existing framework, without requiring explicit subsidies from existing customers. In the Council's submission any expansions that require explicit subsidies from existing customers to new customers do not meet an appropriate definition of rational and should not proceed.

17. Exhibit JT1.17 from EB-2015-0179 illustrates how most of the projects that Union is considering over the near term are likely feasible without explicit subsidies from existing customers.

[4] Tr. Vol. 5, p. 120

18. The exhibit illustrates the CIAC that would be required in order to meet a PI of 1.0 for the 29 "top" projects proposed by Union assuming that Union's proposed $ .23 per m3 TES was collected until the project PI reached 1.0 or had been collected for Union's proposed maximum of 10 years.[5]

19. Setting aside the proposed Kincardine project, the exhibit shows that only 4 of the remaining 28 projects require a CIAC in excess of $2M, with 18 of the projects requiring CIAC's of less then $1M.

20. With this exhibit as the starting point, the Council suggests that the combination of the following factors can facilitate most, if not all of these projects without requiring any subsidy from existing customers:

    a) Union has proposed adjustments to the DCF analysis in its evidence that will have the effect of increasing the natural PI for these projects;[6] the Council endorses the proposed the adjustments, which if adopted will decrease the resulting CIAC required to bring the projects up to a PI of 1.0;

    b) Union notes that most of the proposed projects are in the early planning stages, with capital budget estimates that include contingency amounts of approximately 25% such that on average the capital costs should go down, with the result that the natural PIs will go up.[7] In terms of the magnitude of the possible reduction, the 25% contingency amount that remains in 24 of the 29 proposed project estimates is approximately $11.78M, compared to the $27.93 total required CIAC for those same 24 projects before making any adjustments;

    c) Union's proposal for a surcharge has a maximum term of only 10 years, whereas EGD has proposed a maximum term of 40 years for their equivalent surcharge that, if applied to Union's proposed projects, would make many of the projects feasible without a CIAC.[8] For those projects that do not reach a PI

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[5] The Council recognizes that the projections in the exhibit also include 10 years of ITE revenue.

[6] Ex. R 15 - A\T1 pages 13 and 14.

[7] Ex. S15.Union.BOMA.76 a) notes that only 5 of the projects have had detailed costing performed on them, with the contingency amounts having been reduced from 25% to either 10% or 5%. Union goes on to assert that "For the remaining 24 projects, high level cost estimates were developed. The contingency amounts within the estimated costs are approximately 25%. It is expected that the contingency amount will reduce for each project once detailed designs are completed. Absent an increase in other capital costs related to the project, the "natural P/I" would increase."

[8] Ex. J5.6 suggests that 10 of the 29 projects would require no CIAC at all by extending the TES, with the maximum term for those projects being only 25 years.

of 1.0 using a 40 year term, the additional revenue would nevertheless increase the PI, decreasing the required CIAC;

d) In addition to extending the term of the TES, there is arguably room to increase the TES rate from $.23 to $ .46 per m3 or higher and still provide an ongoing benefit for new customers from the expansion;[9] increasing the TES amount would again improve individual project PIs with the effect of either decreasing the necessary CIAC or possibly bringing the PI up to 1.0, particularly when combined with other proposed adjustments;[10]

e) The availability from the provincial government of up to $200M in interest free loans and $30M in grants for these expansions has the potential to drastically improve the viability of these projects, particularly to the extent that the funding is made available to be applied as a CIAC;

f) Many of the proposed projects are small in scope, such that they can be absorbed into the rolling portfolio requirements pursuant to the Board's EBO 188 Guidelines if the combination of adjustment outlined above result in a PI above .8 but below 1.0.[11]

21. With respect to the Kincardine project, the Council recognizes that it is not as immediately obvious that the project can be justified under the existing project specific and portfolio PI requirements given its size. However, the Council maintains that the information provided by Union with respect to the project does

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[9] Ex. S15.Union.CCC.14 a) confirms that in 2014 the New York Public Services Commission approved a surcharge of $ .78 per m3 for new customers; the response does not indicate whether the converted surcharge was in Canadian or American currency, but in either case the resulting surcharge is more then 3 times the surcharge proposed by Union and Enbridge. According to EB-2015-0179 Ex. A\ T1 UPDATED page 19, Union asserts average annual savings from conversion of $1646 and $1,649; doubling the TES charge to $.46 per m3 would increase the average annual surcharge amount to $1,012, leaving, on average, $634 to $637 in annual savings for new customers.

[10] The Council acknowledges that drastic increases to the proposed surcharge can have a negative effect on the forecast number of conversions with a cascading effect on the forecast project revenue; however it is not the Council's proposal that the surcharge be necessarily fixed at a level 2 or 3 times the level proposed, only that in the context of reviewing a particular project that it be open to utilities to propose a project specific surcharge that accounts for project specific details.

[11] At Ex. R15 - A\T1 page 8 Union asserts that the historical positive NPV in its rolling portfolio could have been used to fund some community projects had those projects been allowed to proceed with an individual PI under .8; presumably making adjustments to bring projects up to .8 will enable even more of those projects to be accommodated under the rolling portfolio requirements without the need to compromise the individual project PI minimum.

establish that the project could likely proceed under the existing requirements with an appropriate surcharge.

22. The Council notes that Union forecasts the potential annual savings from the Kincardine project to be approximately $15M per annum, excluding the savings that could be experienced by contract customers.[12] This compares to a required CIAC of approximately $38.88M to bring the project up to a PI of 1.0 when assuming a surcharge of only $ .23 cents per m3 over 10 years and assuming only a 51% conversion rate with respect to the potential customers (Union asserts there are 8,331 potential customers, but forecasts only 4,250 customers will convert for the purposes of its economic analysis[13]).

23. Union has said that the $ .23 per m3 surcharge is equivalent to approximately 1/3 of the annual savings an average customer will realize upon conversion.[14] This implies that of the $15M (more if contract customer savings were included) in potential annual savings available to Kincardine customers, Union is accessing only approximately $2.15M of those savings on an annual basis in its proposal in order to fund the project.[15] The Council respectfully submits that it is incumbent on Union, as the regulated distributor wishing to invest in the $66M project, and the municipalities (and through them, their customers) requesting that the project go forward to serve them, to provide a rate structure and demonstrate a commitment to the project that accesses more then 14% of the potential annual savings they are seeking to create in order to fund the project. The solution, the Council respectfully submits, should not be to advocate for a regulatory process that simply and automatically spreads the costs of the investment over Union's existing customers, particularly when those existing customers do not benefit from the $15M in annual savings that the project seeks to create.

24. Additionally, the Council notes, the South Bruce Municipalities that would be served by the Kincardine project have rejected Union as the project proponent, having selected EPCOR as their preferred distributor. EPCOR and the municipalities have generally refused to divulge the specifics of the project they intend to undertake. However, on cross examination the municipalities suggested that at the moment they were not sure whether and to what extent the EPCOR proposal would require funding external to the potential new customers in order to proceed with the project:

> MR. MONDROW: So I think it was you, Dr. Murphy, that answered or confirmed -- it might have been Ms. DeMarco that it's the Southern

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[12] EB-2015-0179 Ex. A\T1\Appendix D page 1.
[13] EB-2015-0179 Ex. A\T1\Appendix D page 1.
[14] EB-2015-0179 Ex. A\T1 pages 19 to 20.
[15] .23 cents per m3 x assumed annual average consumption of 2200 m3 x 4250 customers.

Bruce position that external funding will be required to have its gas distribution project proceed?

MR. MURPHY: I don't know that. I really don't know that. It depends on what comes out of the analysis that EPCOR does. They are actively involved in looking at this.

We were dealing with preliminary numbers, so they may very well solve the problem.

MR. MONDROW: Okay. Could we go to the Southern Bruce response to CCC number 3, which you were taken to before?

I'm looking at the -- and part of this question and the answer – sorry, but this was a complicated question. But part of the question was this question about whether external funding would be required, and I took the first bullet to say yes. But I take it, Dr. Murphy, that in fairness you'll have to see, depending on how the economics and the proposal shakes out.

MR. MURPHY: Uh-hmm.

MR. MONDROW: That's the evidence that you are going with?

MR. MURPHY: Uh-hmm.

MR. MONDROW: You have to say yes, please, for the record.

MR. MURPHY: Yes, and there is beyond all this the so-called government funding that's out there that could be used in a variety of ways to help deal with the problem as well, so it is all undetermined.[16]

25. This exchange, coupled with the assertion by the South Bruce Municipalities that they estimate the potential savings from the EPCOR project to be $27M per year[17] as compared to the Union forecast of $15M, suggests that it is quite possible that the Kincardine project as conceived by EPCOR may properly harness the annual savings they expect their proposed new customers to experience to fund the project.

EGD'S PROPOSALS:

26. EGD has proposed a framework that would expand natural gas service to 40 communities (39 projects) at a capital cost of approximately $400 million, serving approximately 16,000 customers. The proposed subsidy from existing customers is projected to be $123 million and the benefits to the new customers would be in the order of $357 million.[18]

27. The major components of EGD's proposals are:

    a) A System Expansion Surcharge ("SES") of $ .23 m3 to be collected by all customers for up to 40 years. In the case of small main extension projects the SES would be applied until the project achieved a PI of 1.0;

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[16] Tr. Vol. 3 pp. 211 to 212.
[17] Tr. Vol. 3 p. 146.
[18] Tr. Vol. 1, p. 23.

b) An Incremental Tax Equivalent ("ITE") to provide municipalities with a mechanism to contribute toward the feasibility of the project to be in place for 10 years;
c) A separate Community Expansion Portfolio ("CEP") which is a separate rolling project portfolio maintained on a rolling basis at a PI level of .5 or greater;
d) Y-factor treatment to capture the incremental revenue requirement associated with annual capital expenditures related to community expansion projects.[19]

Analysis of EGD's Proposed Projects:

28. A review of the 39 projects contemplated by EGD suggests, the Council respectfully submits, that many of them simply do not meet any reasonable definition of a rational expansion. Even with the implementation of an ITE and SES the majority of the projects have PIs of less than .4.[20] Even with the ITE and the SES the Mono Township PI is only at .15.[21]

29. Ex. K2.1 compares the average annual savings that a new customer would expect to realize by converting to natural gas to the actual effective cost of natural gas for customers on a project-by-project basis. The exhibit does this by using the project specific 40-year SES charge that would be required in order for the forecast new customers to fund the project to a PI of .8 as a simply proxy for the incremental cost of serving new customers in those project areas beyond EGD's existing rates.

30. The comparison reveals that even if new customers in these projects were only required to bring the project up to a PI of .8 (as opposed to 1.0), 25 out of the 39 projects result in annual natural gas costs that are higher then the average annual cost of the prevailing alternative fuels. Another 10 projects have annual savings that are so marginal that the payback period on the average cost of customer specific conversion to natural gas appliances is over 10 years (and the annual savings would likely disappear entirely if the surcharge were set to achieve a PI of 1.0). Only 2 projects have payback periods below 5 years, and even then it is only because the project specific surcharge was calculated to bring the project PI to .8 as opposed to 1.0.

31. In the Council's view most of these projects should be naturally excluded by the framework that is put in place on the basis of their economics, which reveal them to be projects that result in a total cost of natural gas service that is in most cases well in excess of the prevailing cost of the status quo alternative fuel. In the Council's submission rational expansion of natural gas service does not mean extending natural gas service at a cost that exceeds the cost of the existing alternative fuel.

[19] Ex. R3/pp. 15-26.
[20] Tr. Vol. 1, p. 18.
[21] Ex. R3/p. 27

The only way new customers would convert to natural gas service under such conditions would be if the costs of natural gas service were paid for by someone else. If that someone else is supposed to be existing natural gas customers as part of subsidy scheme, then the Council respectfully submits that it would be irrational to justify uneconomic natural gas expansion by "spreading the costs" amongst existing ratepayers. Artificially creating value for one customer by offloading the costs that that customer incurs onto other customers does not, in the Council's view, result in just and reasonable rates.

GENERAL SUBMISSIONS:

32. The Council does not support the proposals being advanced by Union and EGD for community expansion. As a matter of principle existing customers should not be required to fund uneconomic expansions into new communities where the costs of doing so considerably outweigh the benefits. The Council is not opposed to expanding natural gas service in Ontario, but only if those that receive the natural gas service, and all of the benefits that accrue to them from natural gas, pay for the expansion. The EBO 188 Guidelines were established to ensure that existing customers are held harmless from the cost of new connections, and we believe that this important objective should be maintained. Under Union and EGD's proposals it is primarily existing customers that assume all of the risks and costs associated with the proposed expansion projects. This is neither rational nor fair. Costs and benefits should be aligned. Those receiving the benefits should bear the costs.

33. If the Ontario Government decides that natural gas expansion into new communities should be subsidized this should be done through the government's general revenue. If it is an explicit policy choice to promote natural gas expansion over other fuels on the basis that it is good for the Province, provincial funding is the appropriate mechanism to fund that expansion. We note that there is no mention of using the existing customer base to facilitate natural gas expansion in the materials provided by the Provincial Government regarding these issues over the past several years.

34. In assessing these proposals and a potential new framework for expansion it is important to be clear about the problem the Board and the Government are trying to solve. The task at hand is to find ways to extend natural gas service to currently un-served communities so the customers in those communities will benefit from the attributes of natural gas and have access to potentially lower cost fuel. From the Council's perspective that is an important goal. However, it is not the case that all expansions make sense and proceed. Using EGD as an example, it is proposing to spend $410 million to connect 16,000 customers at an average cost of over $25,000 per customer, with many of EGD's proposed expansions at a much higher cost per customer; the Council respectfully submits that it remains important to consider the economics of each proposed project within a framework that seeks to facilitate rational expansion, not a framework that simply seeks to maximize expansion.

35. The obvious hindrance to expansion is the cost of doing so. Under the current framework just about any expansion is feasible if the cost of the expansion is fully supported by the distribution revenue generated by the newly attached customers. To the extent the new revenue does not support the cost of the expansion new customers have the option of making up any shortfall by providing a CICAC to supplement the distribution revenue generated by the project. When the necessary capital contribution will not or cannot be paid by the proposed new customers or by some third party on their behalf there is, currently, no alternative for the proposed expansion.

36. Providing for a surcharge allows new customers to leverage the net benefits they will receive from natural gas service (if such net benefits exist) to contribute to the revenue stream for a proposed expansion. Depending on the value of the proposed surcharge and the term over which it is proposed to be in place the additional revenue has the potential to materially improve the PI of a proposed expansion, in some cases to the point where the distribution revenue from new customers (both from base distribution rates and from surcharge revenue) will support the expansion.

37. The Council does not believe that it is appropriate to design a framework that necessarily gives Union and EGD equal opportunities to expand. There is not a "Union" list of projects and an "EGD" list of projects that need to be addressed separately; there is simply a master list of communities that do not have natural gas, and the Board's framework should be designed to facilitate rational expansion where the opportunity to rationally expand genuinely exists. From the Council's perspective this should not be viewed as an exercise designed to find a way to fund all of the expansion projects proposed by Union and EGD, or to provide similar expansion opportunities to both companies.

38. The Council is not opposed to changing some of the elements of the EBO 188 Guidelines to facilitate further gas expansion in Ontario. Allowing for mechanisms that can enhance the economics of a project through surcharges paid by the new customers and their municipalities should be permitted. The Council proposes that the utilities be permitted flexibility around these surcharges. For each project proposal the utility should be permitted to present a detailed analysis of the project elements and economics in order to demonstrate that it can generate adequate revenue from the project through both distribution rates and an approved surcharge to fund the project. Surcharges that vary from project to project should be permitted as should the length of time those charges stay in place.

39. In addition, the Council supports changes to the DCF analysis (as required by the EBO 188 Guidelines) as proposed by Union and referenced above[22] that bring further flexibility in determining the economics of a project.

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[22] Ex. R 15 - A\T1 pages 13 and 14.

40. Below we set out some further problems and concerns with the proposals being advanced by Union and EGD.

OTHER ISSUES:

Risk:

41. There are a number of risks associated with the expansion into new communities. From the Council's perspective Union and EGD's proposals place an increased risk, relative to today on existing customers. These include forecast risk both with respect to customer attachments and capital costs. To the extent that the forecast customer attachments are overly optimistic or change during the project term it is the existing customers that will pick up the shortfall. If capital costs exceed the forecast it is the customer base that will pay for the increased capital costs. Weather can ultimately impact the revenue that the utilities receive to recover the costs of the expansions as well. This too can increase distribution rates. Union's use of deferral accounts put all of this risk on the existing customer base.

42. With respect to the utilities, both Union and EGD have admitted that their shareholder is not taking any risk under their proposals and are not prepared to take on any risk.[23] The benefits to them include expansion of their customer base and earning a return on the assets that are put in place to facilitate the expansion.

43. Union and EGD are asking their customers to fund a considerable amount of the new expansions and be subject to the implications that arise with respect to forecasting risk along the way - with ostensibly no benefit. Union and EGD can decide to move forward with expansions (or not), and the new customers also have choice as to whether or not they want natural gas service once it has been brought to their community. The Union and EGD approaches do not give current customers any choice. The Council submits that this is contrary to the purpose and intent of the EBO 188 Guidelines.

44. Throughout the proceeding there was continued reference to the significant benefits that would flow to new customers as a result of natural gas expansion. In addition, the utilities and many other intervenors provided evidence regarding the potential benefits to the communities that are seeking natural gas expansion. Under the proposals being advanced by the Council regarding flexibility with respect to the surcharges, there is no reason why the benefits accruing to new customers and the municipalities cannot be used to fund the expansions.

Lack of Customer Engagement:

45. The OEB in recent years has placed an increased focus on customer engagement. Both the electric and gas utilities have been mandated by the Board to enhance their

[23] Tr. Vol. 1, p. 60 and Ex. A/T1/p. 6/EB-2015-0179.

customer engagement and the Board itself is becoming more consumer-centric. Union and EGD indicated that on an ongoing basis they are in touch with customers and communities that want natural gas service. And, in the development of some of their expansion projects, they have surveyed their potential new customers regarding willingness to pay.[24]

46. EGD and Union did not survey their existing customers to see if they would support subsidizing these community expansions. They have both attempted to justify this on the basis that the subsidies are so small these customers do not really care. Mr. McGill characterized the subsidies as a "pretty much a red herring" given they are so small on a per customer basis. Assuming the projects go ahead as proposed by Union and EGD, the subsidies will be in the hundreds of million dollars. EGD also implied that the issues were simply too complicated to build a survey around.[25]

47. The Board should be concerned about this lack of engagement and the fact there is no evidence that Union and EGD's existing customers support subsidizing expansions to un-served communities. The reality of the proposals, as currently structured, means that in some cases you may well have low-income consumers funding expansions for consumers that could easily fund their conversions to natural gas through their own energy cost savings, or through their own means.

48. EGD also admitted that it had not approached all of the communities where there may be potential expansions are to discuss contributions.[26] The utilities should, prior to applying for any expansion projects, demonstrate that they have sought out contributions from the relevant municipalities. Municipalities espousing all of the benefits of natural gas should be willing to contribute more than just a property tax offset.

Treatment of Revenue:

49. The Council is aware that the London Property Management Association ("LPMA") will be submitting a detailed analysis of the difference between treating the surcharge as revenue as opposed to treating the surcharge as a CIAC. The Council has reviewed that analysis and supports LPMA's proposal that approved surcharges be treated as ongoing CIACs.

[24] Tr. Vol. 1, p. 41.
[25] Tr. Vol. 1, p. 41.
[26] Tr. Vol. 1, p. 157.

Detailed Case-by-Case Analysis Required:

50. The Council submits that given the flexibility we are proposing with respect to the surcharges, it will be important for each case to be assessed on its own merits. This case-by-case approach will ensure that the details, as to how the project is funded, can be carefully considered by the Board.

Cost to Serve vs. Current Fuel Costs:

51. For particular projects the perceived benefits to new customers only persist if existing customers pay the costs of the expansion. EGD's proposed framework, for example, does not distinguish at all between a project that creates a real net benefit when comparing the full costs of natural gas as against the prevailing energy source, and a project that relies entirely on a subsidy provided by existing ratepayers in order to artificially create value for new customers. EGD's proposal does not evaluate the reasonableness of any specific project at all. Union's proposal attempts to impose an economic standard on its projects by imposing a minimum PI of .4, however this still results in facilitating projects where the full cost of natural gas service is more then the cost of the existing alternative, which the Council submits is unreasonable.

52. The Council notes that London Economics essentially dismisses a framework wherein new customers pay the costs of the expansions built to serve them on the theory, in part, that a) the resulting rates may remove the cost saving incentive, and b) the resulting rates will be discriminatory as between existing customers and new customers, as new customers would not be able to access the affordable rates extended to existing customers.[27]

53. With respect to the first of these two assertions the Council respectfully points out that it is necessarily true that if the costs to serve a customer (absent a subsidy) result in rates that are devoid of a cost saving incentive relative to the existing energy source, it is because there is no cost saving incentive to pursue; the so-called cost saving incentive only exists if artificially created through the subsidization of the costs to serve the customer. Put more simply, if paying to have natural gas distributed to a house costs more then using electricity, it is because paying to have natural gas distributed to the house is more expensive then using electricity.

54. With respect to the second of the two assertions the Council respectfully points out, and London Economics agrees, that one of the cornerstones of energy regulation is cost causality.[28] Accordingly it cannot be the case that setting rates on the basis of cost causality is *de facto* discriminatory, even if doing so means that some customers will pay more for natural gas service then others. The existing EBO 188 Guidelines have essentially enshrined the principle that to the extent new customers are more

[27] Ex. A/S11 p. 14 paragraph 1.
[28] Ex. A /S1 1 p. 12.

expensive to serve they are required to pay more for service then existing customers through the requirement of a CIAC.

55. What, then, is London Economics really saying? The Council believes that the driving force behind London Economics' analysis of different ratemaking regimes (and its particular criticism of a regime that recovers the cost of serving new customers from new customers) is summarized in the following excerpt:

> Mr. Goulding: So my discussion gets back to the question of what do we want a public utility to do. And in terms of meeting those mandates, what is the most appropriate or economically efficient way of meeting those particular mandates?
>
> And, consequently, if we believe that access to natural gas is a cornerstone of public policy, if it is something that is encouraged by policy makers, then clearly we want to set up the conditions in which customers that are provided access actually have the economic incentive to switch and customers that have access to existing rates have the option that would not be granted to those new customers.[29]

56. In other words, London Economics starts from the presupposition that policy makers, in the case the Ontario Government, have established "access to natural gas" as a cornerstone of public policy, and that accordingly the task of the regulator is to facilitate that mandate in an economically efficient manner. From that perspective a regulatory regime that discourages customers from connecting to natural gas (as a result of having to pay the actual cost of connection) does not result, it would seem for London Economics, in the conclusion that some other form of energy remains more suitable for those customers. Instead, where the costs to connect a customer are in excess of the benefits to the customer, a distributor who is responding directly to a policy requiring access to natural gas is compelled to support a different regulatory regime, one that enables not only economic, but also uneconomic natural gas service expansions.

57. The problem with this view is that it is founded on the idea of a public policy directive that does not exist. There is no public policy directive to enable universal access to natural gas no matter what the cost, there is only the public policy objective enshrined in section 3 of the OEB Act "To facilitate rational expansion of transmission and distribution systems."

58. The Council does note that London Economics also relies in part on the notion that there may be a public good, specifically the reduction of emissions, that could compel a regulator to look outside of new customers to fund natural gas expansion:

[29] Tr. Vol. 2 pp 19.

> And so, if, for example, we took a look at the value of avoided emissions relative to the cost of connecting those customers and we determined that that value was reasonable for society, then the next question I would have is: Is looking at this through some other mechanism than simply charging that customer the full cost reasonable, and what is the most administratively simple way of accomplishing that?[30]

59. However, London Economics admits that it took no steps to establish that such value exists.[31] Furthermore, the Council respectfully notes that to the extent there is ostensibly some benefit to new customers in converting to natural gas as their energy source, a material source of the apparent financial benefit comes from converting from electricity to natural gas, with the effect that in many instances converting to natural gas will likely increase rather then reduce emissions.

60. Even if, after appropriate research, it were determined that converting customers from other energy sources to natural gas was an appropriate way to reduce carbon emissions as a matter of public policy such that doing so warranted public funding (a determination that the Council asserts has clearly not been made by policy makers, as illustrated by the requirement that carbon emissions in the Province will be reduced by way of the proposed Cap and Trade Program, suggesting a policy of reduction in natural gas use rather then a policy of increased reliance on natural gas) that funding should be provided by all Ontarians, as emissions reductions benefits all citizens, not just the subset of citizens that happen to be natural gas users.

OEB ISSUES LIST:

61. Below the Council has overlaid its views in this proceeding onto the Board's approved Issues List.

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

The Council respectfully submits that a distinction between a community expansion and "regular" expansion is unnecessary in a framework, such as the one proposed by the Council, that does not provide for explicit subsidies from existing customers to new customers. In the Council's submission all of the modifications that it recommends can be applied to any proposed project.

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? What, if any, changes to the OEB's jurisdiction

[30] Tr. Vol. 2 p. 13.
[31] Tr. Vol. 2 p. 13.

would be helpful in allowing the OEB to foster the rational expansion of natural gas service in Ontario.

In the Council's view the OEB does not have the legal authority to establish a framework whereby the customers of one regulated distributor subsidize the expansion undertaken by another regulated distributor into communities that do not have natural gas service.

The OEB's authority to set the rates charged by distributors is grounded entirely on s. 36 of the *Ontario Energy Board Act* (OEB Act). The OEB can only establish rates to be charged by a regulated distributor for the distribution of natural gas by that distributor to its customers; establishing a rate on the basis of the cost of distribution services provided by another regulated entity to its customers falls outside the legal authority granted by s. 36 of the OEB Act.

The Council does not believe the OEB's jurisdiction needs to be changed in order to effectively foster the rational expansion of natural gas service in Ontario. In the Council's view the rational expansion of natural gas service can be appropriately fostered using the Board's existing powers under the OEB Act, primarily by allowing regulated distributors to levy a surcharge to its new customers as one of the rates it charges for the provision of natural gas service, and secondarily through revisions to the analysis of project economics within the existing EBO 188 Guidelines. To the extent the Board's jurisdiction does not facilitate a particular project, it is because, in the Council's view, the project is such that it should not go forward, not because there is something lacking in the Board's jurisdiction.

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?**

The Council does not agree that there are merits to an approach that has customers of one regulated distributor provide funding towards project undertaken by a 3rd party regulated distributor for the benefit of that distributor's customers. To the contrary, the Council believes that such an approach unjustifiably distorts the rational expansion of natural gas by making uneconomic expansion appear economic by having customers of one utility bear the costs incurred by the customers of another utility.

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?

No; a review of the potential projects suggests that rational expansion of the natural gas distribution service in Ontario can be facilitated without compromising the requirement that the overall portfolio of a distributor be maintained at 1.1 or higher and include only projects that meet a .8 PI or higher.

In the Council's view no individual project should proceed unless it makes rational sense to do so. In the context of so called community expansion projects, rational, the Council respectfully submits, primarily means that there is a net economic benefit for new customers as a result of the project assuming new customers are (ostensibly) solely responsible for paying the costs of the project, subject only to the availability of unregulated external funding (i.e. through provincial grants and loans).

Under the current EBO 188 Guidelines this definition of rationality has been translated into a minimum project PI of .8. The Council respectfully submits that this lower limit provides a sufficient margin of error in terms of a project's economics in order to avoid eliminating projects that on a forecast basis may appear uneconomic but which have a sufficient prospect of being economic on an actual basis (i.e. if the number of actual connections is closer to the potential number of customers than what is forecast in the DCF analysis). This margin of error is acceptable in part because it operates in combination with the overall portfolio PI requirement of 1.1, which means that any forecast shortfall in revenue from a new project will be (more than) made up by excess revenue from other new projects, with the result that existing customer are continually held harmless (and in fact should experience slight downward pressure in rates) as a result of the rational expansion of the natural gas system.

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?***

All of the adjustments to the DCF analysis proposed by Union should be incorporated into all feasibility tests;[32] this would have not only the direct effect of increasing the PIs of the proposed community expansion projects, but would also serve to increase the excess revenue from "regular" expansion projects for the purpose of maintaining the portfolio over at or above 1.1, expanding the ability of a distributor to entertain projects with individual PIs under 1.0.

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?**

[32] Ex. R15 A\T1 pages 13 and 14.

The changes to the DCF analysis endorsed by the Council do not require fundamental changes to the EBO guidelines; the basic project specific and portfolio guidelines would remain intact, it is only the scope of some of the inputs into the DCG analysis that would be broadened.

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?

As noted the Council does not believe there is any need to distinguish community expansion projects from "normal" projects within a framework, as proposed by the Council, that does not allow for explicit subsidies either between existing customers and new customers that are both being served by the same regulated distributor or between the customers of different distributors.

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?

As noted the Council does not believe there is any need to distinguish community expansion projects from "normal" projects, and therefore no need to consider exempting certain costs from consideration when dealing with some sub set of proposed 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 the Council's view the economic, environmental and public interest components in not expanding natural gas service to a specific community are appropriately (and implicitly) considered within a framework that, as proposed by the Council, continues to ensure that new customers bear the full costs of extending natural gas service to them. Under such a framework issues around the economic, environmental and public interest differences between natural gas and alternative energy sources such as electricity and propane will be resolved on the basis of their actual economic, environmental and public interest attributes. This is particularly the case wherein the environmental and public interest differences between energy sources are, to a large extent, being converted into economic differences through the Cap and Trade Program, such that an energy source's cost will be adjusted relative to other energy sources by the impact that energy source has on carbon emissions.

5. Should the OEB allow natural gas distributors to establish surcharges from customers of new communities to improve the feasibility of

potential community expansion projects? If so, what approaches are appropriate and over what period of time?

Yes; surcharges are simply a different mechanism to allow potential new customers to address the shortfall in the economic feasibility of a project, in the same way potential new customers can address that shortfall by providing a Contribution in Aid of Construction.

The Council respectfully submits that the Board need only establish a maximum volumetric based surcharge and a maximum term over which that surcharge can be levied, and allow distributors wishing to proceed with a project that requires surcharge based revenue in order to become economic to apply for approval of the project based on their assessment of an appropriate project specific surcharge amount and term. To the extent that, for example, a distributor wishes to use a uniform surcharge level across proposed projects they would be at liberty to do so, although that might limit its ability to do some projects and their ability to respond to project specific economics. Distributors should also have the ability (and the responsibility) to adjust the surcharge to account for material changes in the project economics, i.e. in the event there is an influx of customers in a project area beyond what was contemplated at the time of the project's approval (either by a material increase in the conversion of potential customers or by the addition of new customers through new development) the surcharge amount or term should be adjusted down to reflect the improved economics of the project.

As noted earlier the Council is aware that the LPMA will be submitting a detailed analysis of the difference between treating the surcharge as revenue as opposed to treating the surcharge as a CIAC. The Council has reviewed that analysis and supports LPMA's proposal that approved surcharges be treated as ongoing CIACs.

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

The Council does not believe that any other approaches beyond those it proposes are necessary. However, to the extent other parties recommend other approaches that compliment or contradict the approach the Council proposes, the Council will comment on those approaches in reply.

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?**

No; the only exceptions to the approved IRM framework are enumerated Y factors and Z factors. While some of the projects may be large enough to qualify for Y factor treatment, most will not. None of the projects qualify for Z factor treatment, as the choice by utilities to undertake or not undertake an expansion project remains within their discretion. In any event, the framework proposed by the Council is grounded on the principle that new customers remain responsible for the costs of expansion undertaken to serve them, primarily through the use of expansion surcharges. Since the Council does not endorse a framework that explicitly requires subsidies from a distributor's existing customer base, there is not the same need to account for a shortfall in project revenue pending rebasing; any such shortfall should predominantly be recovered through the surcharge, which the distributor can levy immediately.

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? Should the Municipal Franchise Agreement approval process be accompanied by a selection process? Who should conduct the process and what should the selection criteria be? How would the needs of large users be considered? Submissions on the current purpose and use of the Municipal Franchise Agreement would also be of assistance.**

See the Council's submissions on Issue 9.

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 Council is aware of only one recent instance where a distributor other then EGD or Union expressed an interest in becoming a licensed distributor and serve a currently un-served community, and that is in relation to the community of Kincardine. In that single example it does not appear that potential new entrants were disadvantaged; to the contrary, the Board's EBO 188 Guidelines required Union to offer service to Kincardine on the precondition of a prohibitive CIAC requirement, which the Council presumes greatly hindered Union's ability to compete with new entrants who were able to offer service on the basis of a project specific rate. To level the playing field in that regard Union has proposed that it be permitted, if necessary, to propose community or project specific rates in order to compete with new entrants on a like for like basis;[33] the Council supports this proposal, in addition to the ability for any distributor to propose an appropriate surcharge in lieu of a CIAC in order to adequately support a project's economics.

As noted above the Council does not agree that the Board has the jurisdiction to create a fund by charging rates to one distributor's customers and distributing the resulting monies to another distributor for the benefit of its customers. Consequently the only way new customers can be explicitly subsidized is by

[33] Ex. A/ T1/ p. 13.

allowing utilities to spread the cost of expansion across its existing customer base, a subsidy scheme that is underpinned in this proceeding by the suggestion that the rolling portfolio and project specific PI requirements under the existing EBO 188 Guidelines be compromised. In relation to this issue the Council respectfully points out that allowing distributors to use their existing customer base to subsidize expansion will necessarily disadvantage potential new entrants. More specifically, the Council cannot imagine how any potential new entrant could compete with either Union or EGD were either Union or EGD allowed to undertake projects where the revenue from new customers failed to exceed a PI of .4 (in the case of Union's proposal) or where there was no minimum PI at all (in the case of EGD's proposal).

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?**

In the Council's view the only impact of the proposed cap and trade program to the framework that the OEB should establish is on the economics of a proposed project. To the extent that the costs associated with the cap and trade program make natural gas more or less expensive then the prevailing alternative fuel that new cost differential could affect the specifics of any application for project approval, including what a viable surcharge may be and what a reasonable forecast of connections may look like.

Because the Council's proposal excludes any explicit subsidy from existing customers to new customers, the concern about the impact of the cap and trade program on natural gas costs are the concern of new customers, who always have the option of either pursuing (and paying for) natural gas service, or refraining from doing so based on the economic and other factors they may consider.

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 Council notes only at a high level that the proposed cap and trade program should increase the difference in cost of natural gas relative to some alternative energy sources, and decrease the difference in cost of natural cost to other fuels, all of which will need to be considered by utilities wishing to establish levy a surcharge to new customers in order to make a project economic. The Council presumes that other intervenors will make detailed submissions on the actual impact of the cap and trade program on such differentials; since the framework that the Council proposes keeps the responsibility for the costs of expansion with new customers, it would remain the responsibility of new customers to assess the risks associated changing differentials in energy costs when pursuing an expansion of service and committing to conversion.

The Council would however point out that the simple act of allowing surcharge revenue collected over a term of up to 40 years and forecast on the basis of customer connections to replace an up front CIAC payment materially increases the risk borne by existing customers in relation to a project. Unlike a CIAC, which is calculated and collected from new customers (either directly from them or provided on their behalf by a Municipality or other 3rd party) prior to construction, surcharge revenue is only collected when customers attaching to the new project connect to the system, after the system is built. To the extent an approved project does not attract the required level of connections for any reason including changes in energy cost differentials, existing customers will, on rebasing, bear a greater shortfall then they would have had a CIAC been recovered.

12. **How should the OEB incorporate the Ontario Government's recently announced loan and grant programs into the economic feasibility analysis? The OEB would welcome submissions on how the disbursement of these funds might relate to the OEB's approval of expansions. The OEB recognizes that ultimately the government will decide how this money is best used, but the OEB would like to hear the parties' views on the optimal use of these funds.**

Government funding would seem to have two possible effects on the OEB framework. To the extent that government grants are directly available as an offset to the capital costs of the expansion as a CIAC, the effect is to directly increase the project PI. To the extent that government grants are directly available to offset customers' conversion costs, the effect is to increase conversion rates, and, potentially, provide "room" for larger surcharges to be added to base rates in order to increase the revenue from new customers while still allowing those customers to enjoy savings from their conversion to natural gas. In either scenario the framework proposed by the Council seamlessly incorporates the impact of such funding, since in either case the funding is simply either one of the direct inputs into the DCF analysis for the project or an input into the calculation of a project specific surcharge.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 20th DAY OF JUNE 2016