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June 20, 2016 **VIA E-MAIL**

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
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Dear Ms. Walli:

Re: Vulnerable Energy Consumers Coalition (VECC)
Final Submissions: EB-2016-0004 Community Expansions

Please find enclosed the submissions of the Vulnerable Energy Consumers Coalition (VECC) in the above noted proceeding.

Yours truly,

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EB-2016-0004

ONTARIO ENERGY BOARD

IN THE MATTER OF an Application under the Ontario Energy Board's own motion to consider alternative approaches to recover costs of expanding natural gas service to communities that are not currently served (Community Expansion Policy).

SUBMISSIONS

ON BEHALF OF THE

VULNERABLE ENERGY CONSUMERS COALITION (VECC)

June 20, 2016

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Vulnerable Energy Consumers Coalition (VECC)
Submission with respect to
Community Expansion

1. INTRODUCTION

1.1 This submission has been organized first to discuss what VECC believes are the important elements of our analysis of the practical and policy challenges facing the decision makers attempting to recast an approach to expanding natural gas to unserved communities. Following that analysis, and the exploration of potential solutions, we will attempt to use the conclusions therein to briefly answer the questions posed by the Issues List herein. VECC believes that organization of its submissions will prove helpful to the Board.

1.2 In order to come to any rational and workable conclusions we believe the Board must first walk through the reasons this proceeding came to exist. As well, it must answer the fundamental questions defining this proceedings objective.

Lead up to this proceeding

1.3 This proceeding has its origins in correspondence sent to the Chair of the Ontario Energy Board (the "OEB", the "Board") dated June 26, 2014 in which the Minister of Energy, Bob Chiarelli asked the Board "to examine the oversight of the Natural Gas Sector and to assess what options may exist to facilitate connecting more communities to natural gas." [1]

1.4 By correspondence dated February 15, 2015, Minister Chiarelli wrote 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

[1] EB 2015-0179 Exhibit A Tab 1 Appendix A page 1

communities and to reiterate the government's commitment to that objective**.** The Minister also expressed his appreciation for the support of the Board Chair (and presumably the Board) in ensuring "the rational expansion of the natural gas transmission and distribution system for all Ontarians".[2]

1.5 On February 18, 2015,the Ontario Energy Board gave notice to all applicants and potential applicants for expansion of natural gas service that, in response to a provincial government 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., the Ontario Energy Board (the "Board") was inviting parties with the appropriate financial and technical expertise to propose one or more plans for natural gas expansion.[3]

1.6 In making this invitation, the notice provided that:

> 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 access to natural gas for communities that are not currently served.

1.7 In the same notice, the Board stated that the Government had announced $200 million in natural gas access loans and $30 million in natural gas economic development grants but that no terms for access to these monies had yet been announced.

Union response

1.8 On July 23, 2015 Union Gas filed an application with the Board , EB 2015-0179 responding to the February 2015 Board Notice that requested the following, inter alia:

[2] Ibid
[3] EB-2015-0179 Exhibit A Tab 1 Appendix A p.2

(i) An order approving an exemption from the Board's E.B.O. 188 that would allow individual (Community Expansion Projects to proceed at a profitability index ("PI") of 0.4 or greater.

(ii) An order approving an exemption of Community Expansion Projects from the Board's E.B.O. 188 Investment Portfolio and Rolling Project Portfolio requirements.

(ii) Orders creating a temporary expansion surcharge ("TES") rate for Community Expansion Projects and an incremental tax equivalent ("ITE") mechanism to collect municipal contributions.

1.9 The Union application sought to provide natural gas service for "Community Expansion Projects" for the first time to recipients living in unserved communities of more than 50 residents. The application identified 30 communities where the exemption orders sought may enable expansion of otherwise impermissible expansion.

1.10 In response, numerous parties intervened with a view to opposing the Union application. These included EPCOR raising the issue of competitive bidding for natural gas franchises as a necessary component of any expansion strategy and suppliers of other forms of energy or equivalents objecting to favoring the Union plans with an explicit subsidy by its ratepayers.

Generic Proceeding

1.11 In the result, on January 20, 2016, the Board decided to initiate the current proceeding. The Board concluded in correspondence at that time directed to interested parties that:

> The issues that have been brought forward in Union Gas Limited's (Union) application would be common to all gas distributors including new entrants that wish to provide gas distribution services in communities that do not have access to natural gas. The OEB has decided to establish a generic hearing on its own motion to deal with these common issues.

1.12 In light of the scope of the inquiry of this, the generic proceeding, and that of the Issues List that has framed the same, a brief review of the current Board policy is in order, as well as the jurisdiction of the Board to undertake change in accordance with in its initial objective, and any new framework for system expansion that might eventuate.

2. EBO 188

The Policy and Principles of EBO 188

2.1 VECC has presented in the evidence of Messrs. Hariton and Ladanyi in this proceeding[4] a summary of the history of the Board's approach to system expansion culminating with the current operating policy set by its decision in EBO 188.

2.2 In EBO 134, the Board convened an extensive public hearing that considered the balancing of the economic feasibility of system expansion with public interest considerations.

2.3 In its decision of June 1, 1987, the Board set out its key operating approach in evaluating the public interest in system expansion:

> When considering the public interest in prior proceedings the Board has been satisfied if the welfare of the public is enhanced without imposing an undue burden on any individual, group or class. The Board will continue to be guided by this general principle in determining the extent to which gas service should be extended into other areas of the province.[5]

2.4 The Board then set out a Three Stage Test to evaluate economic feasibility of system expansion that was to be based on incremental costs:

> The first stage is a test based on a DCF analysis.

[4] "Natural Gas System Expansion and Subsidies in Telecommunications", Evidence of George Hariton and Tom Ladanyi, March 21, 2016 pp. 5-13
[5] EBO 134, Report of the Board June 1, 1987, par 5.16

> The second stage should be designed to quantify other public interest factors not considered at stage one. All quantifiable other public interest information as to costs and benefits should be provided at this stage.
>
> The third stage should take into account all other relevant public interest factors plus the results from stage one and stage two.[6]

2.5 With the experience of differing approaches by the LDCs to the conduct of the first stage test, the Board convened the EBO 188 proceeding to review the system expansion policy including an inquiry into system externalities and a portfolio approach to system expansion.

2.6 Following the conclusion of an ADR agreement in the EBO 188 proceeding [7] by interested parties representing LDCs and a broad range of stakeholders, the Board approved a more specific approach featuring the creation of an Investment Portfolio and the Rolling Project Portfolio.

2.7 The Investment Portfolio (IP) is a portfolio of all proposed new distribution customer attachments and facilities for a particular test year. This IP was to reflect a Net Present Value (NPV) of zero or greater and a Profitability Index (PI) of 1.0.[8] As a precaution, this PI was increased to 1.1 to "*minimize the forecast risks and hence more likely achieve the desired results of no undue rate impacts*.[9]"

2.8 The Rolling Project Portfolio (RPP) is the collection of all distribution expansion projects for the past 12 months. The cumulative result of project-specific discounted cash flow analyses of this group would be calculated monthly.[10] This portfolio was expected to maintain a NPV of zero or greater.

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[6] Ibid at para 6.73
[7] And a dissenting report from some ADR attendees
[8] PI is the sum of the Present Value (PV) of Operating Cash Flow plus the PV of the Capital Cost Allowance (CCA) Tax Shield divided by the PV of Capital.
[9] EBO 188, para 2.3.10
[10] The costs and revenues associated with serving customers on existing mains would not be included.

2.9 The Board further adopted a 10 year customer attachment horizon, a 40 year customer revenue horizon for all customers except for a longer horizon of 20 years for large volume customers. All projects were to achieve a minimum threshold P.I. of 0.8 for inclusion in a utility's Rolling Project Portfolio and customer contributions could bring a project PI up to 0.8.

2.10 There are several important aspects of the current policy that are relevant to the issue of the financing of otherwise uneconomic expansion. In the operation of the EBO 188 model, in the first part of the 40 year period, the revenues collected from new customers would be lower than the costs of serving them. This annual revenue deficiency obviously increases rates and is subsidized by existing customers through the rate setting process. Sometime before half way through the 40 years, a crossover would be reached and the revenues from new customers would exceed the costs, creating an annual revenue sufficiency decreasing rates.

2.11 The economic principles of the policy have been summarized in the evidence of Parkland Fuels:

> The overall constraint on portfolio profitability is designed to ensure that existing ratepayers do not cross-subsidize new capital projects in the long-run. At least in the long-run, new capital projects are expected to pay for themselves.
>
> Within a portfolio, however, there could be some cross-subsidies from profitable projects to unprofitable projects, as individual projects can proceed with a profitability index of between 0.8 and 1. There may even be many more unprofitable expansion projects within the portfolio that one or two profitable projects pay for.[11]

2.12 As noted in the accompanying footnote, the emphasis of the Board's policy is on the long-run because the profitability calculation is done in present value terms. As long as cash flows in later years, discounted at the utility's cost of capital compensate for early losses, there would be no cross-subsidy over the relevant time horizon that the test evaluates profitability. If however, the portfolio operates at a PI of less than 1 then a subsidy occurs.

[11] Dasgupta and Nieberding, Section 5.2, pg.15

2.13 Another implication of this model is that "rolled-in" pricing provides an inherent advantage to incumbent utilities. For example, Union estimates that there is a "benefit" $0.50 per year for each existing customer related to the attachment of the 29 potential community expansions. Of course, there is no overall "benefit" to existing consumers, since by definition these projects are net money losers. It would be more accurate to state that Union is able to able to minimize the subsidy required for expansion by the amount accruing due to its existing infrastructure.

2.14 The Board should be cautious overstating the effect of this externality. Existing customers of incumbent utilities are unambiguously always financially better off not having to provide a subsidy, or having to accept additional risk of the system expansion into marginally economic areas as is the case under the EGD's and Union's ("the Utilities" herein) proposals in this proceeding. The fact that there is a small reduction in the subsidy required of the incumbent utility due to its marginal cost for some distribution services is also not of significance. In determining who should serve a franchise, it is the total cost to serve that is relevant.

2.15 Generally, since the EBO 188 decision, both incumbent utilities have applied the Board's policy in a similar fashion. And similarly, both have run out of economically viable extensions to their system under the current rule.

2.16 Both utilities seek exemption to, rather than modification of, the current policy.[12] However, in our view, the Board should consider whether slight modifications to the current policy are sufficient to serve perceived government policy changes.

Expansion within the current policy

2.17 Before embarking upon major departures from a policy which has been accepted for almost 20 years, the Board might consider whether modest liberalization of the

[12] Transcript Vol. 6, pg.5

current policy could accommodate the direction in government policy expressed in the ministerial correspondence referenced above.

2.18 Both Union and EGD were asked what modest changes to the current policy would have.

2.19 In speaking to the EBO 188 portfolio, EGD noted that from 2001 to 2015 the Company's Investment Portfolio PIs ranged from a low of 0.95 to a high of 1.80, with a cumulative net present value amounting to over $650 million during this time.[13] This is a clear indication that over this period of time the customers that were added to the Company's distribution system have subsidized the existing customers, as opposed to the opposite.

2.20 Union noted the effect of this proposal in its response to Undertaking J6.12

> In the absence of TES and ITE, no projects would reach the minimum project PI of 0.8. With the TES and ITE as proposed, only three projects would reach the minimum PI of 0.8 and in this case the IP PI would remain above 1.0. Thereafter, since Union's project list is generally sorted by declining project PI, further projects would require relaxation of the minimum project PI to something below 0.8, and the number of projects that could occur each year would be limited to Projects with total capital costs in the same range as the three projects noted above (approximately $7 million per year)[14]

3. FINANCING EXPANSION

Alternative Means of financing

3.1 Both Union and Enbridge propose to raise monies for the projects three ways: (1) a general rate increase for all existing customers; (2) a System or Temporary "expansion surcharge" (ES) – for either 10 or 40 years, and (3) municipal tax rebate. The latter is arguably categorized as a reduction in the cost of service.

[13] Exhibit S3.EGDI.EP.2

[14] J6.12, pg. 216

3.2 It is clear that the Board currently has jurisdiction to approve an expansion surcharge. The distinction as between Union and Enbridge in respect to the term of the charge might be more properly discussed as the difference between a surcharge (Union) and creating a new rate class (Enbridge). In either case, the surcharge is based on the concept of cost causality, and clearly falls within the ambit of the traditional rate making powers of the Board.

3.3 The new component, introduced presumably to reflect the stated economic benefits to the locality to be served, is the municipal tax rebate. We discuss the issue of the municipal tax rebate later below under the issue of Franchise Competition.

3.4 The issue of compelling existing customers to contribute toward non-financially viable projects in pursuit of broad public policy is examined below. Section 4 of this submission examines whether the Board has the jurisdiction to enable subsidization of community expansion.

3.5 Union is seeking $88 million from existing customers. Enbridge would require $439 million to be collected from existing customers over 40 years[15]. Given the amounts of grants and subsidies already announced, it is worth considering why the Board would move in advance of the decisions.

CRTC model for Uneconomic Expansion

3.6 VECC has offered evidence in this proceeding describing the approach of the telecommunications regulator to uneconomic expansion of telecommunications services currently limited to local telephony. It provides the outline of a model that might be considered if the Board elects to create a new subsidy regime available in a new community expansion policy for natural gas.

[15] EGD S3.EGDI.SEC.22; This is in addition to the SES and ITE collected ($414 and $13 million respectively)

3.7 The CRTC approach has not followed one singular path. In 1997, the Commission decided to open the local telephone services market to competition. Given that, with competition, the long established cross subsidy from long distance service was no longer available to either competitors or incumbents, a new subsidy regime was created.

3.8 Under the new regime, subsidies were based on the need to keep local residential rates at an affordable level, as determined by the Commission. In locations where the costs of service were higher than such rates, (deemed high cost serving areas (HCSAs)), the difference would be recovered by the service provider through a subsidy (or contribution, as this particular subsidy was referred to). Thus, the subsidy was to be determined by shortfalls in revenues for certain local services, rather than the pre-competition method of using surpluses for long distance and other services

3.9 The CRTC created a collection mechanism to pay out this subsidy that was designed to "promote fairness, ratepayer equity, economic efficiency, technological neutrality and competitive equity". [16] This was to be done by creating a level playing field by not favouring one service provider or one technology over another.

3.10 The collection of contribution was to be based on network use. To encourage competitive entry, new entrants as well as incumbents were now eligible to collect a subsidy based on prospective economic costs based on the proxy of the incumbent's current costs of expansion.

3.11 In order to collect and administer the subsidy, a single national fund, the National Contribution Fund (NCF), was created with an independent third-party administrator. All customers would contribute equally to what was seen as a social obligation. The Commission chose to base the amount on a percentage of each provider's telecommunication revenues, on the basis that it was the most

[16] CRTC Telecom Decision 2000-745, para 8

competitively fair and equitable. As well, because the contribution was spread across a very wide base, the rate could be kept low, thus reducing distortions and increasing economic efficiency.

3.12 In 2011, the Commission changed the objective of the contribution regime to link it with the obligation to serve. Where service was obligated from an incumbent local exchange carrier (ILEC) within its operating territory at regulated rates (within the affordability standard) that weren't compensatory, the ILEC could be compensated by the NCF for taking on what was perceived to be a social obligation[17]. Contribution from the NCF is now payable only for residential local voice service, to incumbents with an obligation to serve, in non-forborne HCSA exchanges.

3.13 The NCF funded network expansions and upgrades by a different mechanism, commonly referred to as service improvement plans (SIPs). Once again, the Commission responded to the changing telecom environment by instituting a mechanism to ensure the objectives of network connectivity pursuant to the *Telecommunications Act* could be attained.

3.14 With the onset of price cap regulation for local telephone service, rate recovery through the traditional rate setting process for service improvement and service extension expenditures as part of a revenue requirement (with Commission approval) was no longer available. In 1999, the CRTC set the requirements for providing basic service (Basic Service Objective or BSO)) in an ILEC operating territory. ILECs were directed to come forward with SIPs to meet the BSO.

3.15 In 2002, the CRTC directed that SIPs in HCSAs were to be funded through the National Contribution Fund. The costs were added to the economic or current

[17] Since new entrants had no obligation to serve, they were no longer eligible to receive a subsidy from the NCF. As well in 2007, the Commission had started granting forbearance from rate regulation of residential services in localities where there was sufficient competition. There was no NCF funding of ILEC local telephone service in such localities.

costs used to calculate the total subsidy requirement and recovered through the corresponding contribution payments from the NCF. [18]

3.16 As the VECC evidence notes:

> As a consequence of these service improvement plans, and a few others since, voice telephony is available almost ubiquitously in Canada and universal access at affordable rates is no longer much discussed. To that extent, the Commission's programs should be considered a success.[19]

3.17 It is instructive that the CRTC has used the combination of the BSO and the NCF in order to provide or to consider providing funding for video relay service and broadband access. In the case of video relay service (VSR)[20], the Commission found that video relay service should be included as a basic service and that there should be a single national service with the costs funded by the NCF.

3.18 An ongoing proceeding in the CRTC is considering whether to add broadband access to the BSO. By doing so, there would likely arise a need for funding from the NCF to provide subsidies, particularly for satellite-dependent communities arising from the high cost of leasing satellite transponders.

3.19 The current Commission proceeding, noted above, is examining the possibility of holding a reverse auction for the provision of the broadband service to such communities as the satellite-dependent ones previously described. The service provider requiring the lowest subsidy, while meeting standards of service, would receive both the obligation to serve and the subsidy. As the VECC evidence notes, this reverse auction model "has the potential to reduce the size of subsidies to be paid, while encouraging competitive equity"[21].

[18] Currently, the only major incumbent receiving funding from the National Contribution Fund for a service improvement plan is Northwestel
[19] Ibid at footnote X p.11
[20] This service enables hearing-impaired people to conduct telephone calls using sign language.
[21] Ibid at footnote X p. 28

3.20 Competitive auctions have also been used in a limited number of government programs over the last two decades to make broadband access available in a variety of targeted communities. As the VECC evidence notes, the general understanding is that they have been instrumental in extending broadband access at reasonable cost.[22]

3.21 Clearly, the policy driver behind the NCF has been the perceived necessity, derived from the objectives provisions of the *Telecommunications Act* and the historic approach of the CRTC, to ensure access and affordability to necessary telecommunications services now making up the components of the BSO.

3.22 The NCF example cannot help the Board with its determination of the establishment of the degree of importance of the public objective to expand natural gas service to unserved communities and the extent and apportionment of the burden of any subsidy required on existing customers or taxpayers.

3.23 What the NCF does provide is an example where sophisticated utility network services provided by multiple players were extended to the most remote regions of the country. This was done by taking on that challenging task through a central fund based on a percentage of revenue, independently run, and overseen by the regulator.

3.24 In the case of the NCF, the model has not been static and has evolved to accommodate developments in telecommunications technology and competition in the provision of services. The CRTC's current consideration of the success of a competitive auction process in funding otherwise uneconomic broadband service is also indicative of an approach that may be both responsive to the overall public interest in the extension of important network service, and the need for the prudent expenditure of rate revenue.

[22] Ibid at p. 28

4. BOARD JURISDICTION FOR FINANCING UNPROFITABLE EXPANSION

Current Regulatory Model

4.1 The examination of possible alternatives to the current limitations on expansion of natural gas service has triggered a disparate collection of opposition based on issues of jurisdiction, size of expenditures, process efficiency including allocation of costs and benefits, adherence to environmental goals, and potential anti-competitive effects.

4.2 The limits on Board authority to use rates collected from existing customers to finance expansion to communities unserved by natural gas has been a trenchant argument of interested parties that advance the proposition that this practice offends against the Board's statutory responsibility to fashion just and reasonable rates. Even the LDCs themselves are of the view that the OEB is constrained, in some fashion, from using rates collected from one regulated distributor to assist in community expansion projects contemplated by another.

4.3 Whatever the merits of a new community expansion project approach from an efficiency or public interest standpoint, VECC submits that the jurisdictional limitations on policy initiatives by the Board in this matter, as articulated by a number of parties, have largely been discarded by evolving jurisprudence.

4.4 As VECC's evidence notes, the current Board policy has grown out of the two propositions that: [23]

i. Mr. Justice Keith's broad public interest approach to the *OEB Act* [24] "*that all matters relating to, or incidental to the matters relating to, or incidental to the production, distribution, transmission or storage of natural gas…are under the exclusive jurisdiction of the Ontario Energy Board…These are all matters*

[23] Ibid at Footnote 4,, pp.5-9
[24] Currently- Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Sched. B

that are to be considered in the light of general public interest and not local or parochial interests".[25]

ii. A subsidy will be tolerated provided that the subsidy is in the public interest, and imposes no undue burden on any group or class of customers.

4.5 It is hard to square the argument of strict limits on Board authority in setting rates for existing natural gas customers with the current practice and policy. Whatever the merits of the public interest considerations, or arguments about undue burden, it seems difficult to cast the OEB 188 policy in terms of a strict cost of service/rate allocation approach.

Jurisdiction for Change to OEB Policy

4.6 Case law developments since the development of the current policy through EBO 134 and EBO 188 seem to have expanded the scope of judicial deference when the Board acts in accordance with its statutory objectives to fashion rates that may depart from strict principles of allocation of costs of service to the served group or class of customers that incurred the costs.

4.7 A brief review of the salient provisions of the Act is essential in providing the basis for the definition of the limits of Board authority. 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:

i. To facilitate competition in the sale of gas to users;
ii. To protect the interests of consumers with respect to prices and the reliability and quality of gas service;
iii. To facilitate rational expansion of transmission and distribution systems;
iv. To facilitate rational development and safe operation of gas storage;
v. To promote energy conservation and energy efficiency in accordance with the policies of the Government of Ontario, including having regard to the consumer's economic circumstances;
vi. To facilitate the maintenance of a financially viable gas industry for the transmission, distribution and storage of gas; and,

[25] *Union Gas Limited vs. Township of Dawn*. (1977) 76 D.L.R. 613

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

4.8 The *OEB Act* provides for the regulation of distribution rates as follows:

> 36. (1) No gas transmitter, gas distributor or storage company shall sell gas or charge for the transmission, distribution or storage of gas except in accordance with an order of the Board, which is not bound by the terms of any contract…
>
> (2) The Board may make orders approving or fixing just and reasonable rates for the sale of gas by gas transmitters, gas distributors and storage companies, and for the transmission, distribution and storage of gas.
>
> (3) In approving or fixing just and reasonable rates, the Board may adopt any method or technique that it considers appropriate

4.9 In light of the above provisions, in determining the fit and the appropriateness of any community expansion policy or project approval it must be remembered that the classification of potential Board action pursuant to these powers and objectives is seldom a rote mechanical exercise and considerable deference is to be shown to Board expertise. As the Ontario Divisional Court has noted in relation to the exercise of powers by the OEB:

> In this case, the expertise of the tribunal in regulatory matters is unquestioned. This is a highly specialized and technical area of expertise. It is also recognized that the legislation involves economic regulation of energy resources, including setting prices for energy which are fair to the distributors and 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.[26]

4.10 There appears to be scant judicial patience for the insulation of regulatory operations from an over-arching necessity to adhere to the balancing of the Act's statutory objectives. The Ontario Court of Appeal in *Toronto Hydro Electric System Ltd. v. Ontario (Energy Board*)[27], upheld the OEB's authority to require the appellant to obtain the approval of a majority of its independent directors before declaring any dividends. The decision stated:

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[26] o Enbridge Gas Distribution Inc. v. Ontario Energy Board (2005), 75 O.R. (3d) 72, (Div. Ct.)at para 24 Reversed on other grounds in the Ontario Court of Appeal at 2006] O.J. No. 1355

[27] 99 O.R. (3rd) 481 (C.A.)

> The Board was a highly specialized expert tribunal with broad authority to regulate the energy sector in Ontario and to balance the interests of ratepayers in terms of prices and service while at the same time ensuring a financially viable electricity industry that was both economically efficient and cost effective. … The Board's power in respect of setting rates was to be interpreted broadly and extended well beyond a strict construction of the task. The legislation reflected a clear intent by legislators to use both a subjective and open-ended grant of power to enable the Board to engage in the impugned inquiry in the course of rate setting. [28]

4.11 This judicial acknowledgement of the multi-dimensional aspect of rate setting can also be found in the majority judgment of Mr. Justice Bastarache of the Supreme Court of Canada in *ATCO Gas and Pipelines Inc. v. Alberta Energy Board* [29] :

> Rate regulation serves several aims - sustainability, equity and efficiency - which underlie the reasoning as to how rates are fixed[30]

Justice Bastarache then quoted from a regulatory text to the effect that equity meant "*the distribution of welfare among members of society*"...[31]

4.12 While the extent of the potential latitude extended to the Board in fashioning rates appears to be considerable, some actual examples of the principles in action might be instructive.

4.13 In *Advocacy Centre for Tenants Ontario v. Ontario (Energy Board)*, the Divisional Court allowed an appeal of the Board's decision that it had no jurisdiction to order a "rate affordability assistance program" under the Ontario Energy Board Act. The Board was found to have the jurisdiction to establish a rate affordability assistance program for low income consumers purchasing the distribution of natural gas from the utility.

4.14 To come to its conclusion, the majority of the Ontario Divisional Court gave weight to the objective of "protecting the interests of consumers" pursuant to sec. 2(2) of

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[28] Ibid at pg. 490
[29] [2006] 1 S.C.R. 140

[30] Ibid at para 62
[31] Ibid at para 62 quoting R. Green and M. Rodriguez Pardina, Resetting Price Controls for Privatized Utilities: A Manual for Regulators (1999), at p. 5

the *Act* and, the Board's interpretation of the same, to trump a traditional rate setting approach. Pursuant to the sec. 2 objective, the Board could take into account the ability to pay in setting rates, and could do so with its ability to use its choice of any method or technique to set rates under sec. 36(3) of the Act. The Divisional Court was guided by the ordinary meaning of the expansive wording of s. 36(2) and (3) of the Act, as well as the purpose of the legislation provided by the context of the statutory objectives for the Board as set out in s. 2 of the Act.

4.15 The *Advocacy Centre* decision deals squarely with the evolution of judicial recognition of the achievement of statutory objectives in rate setting that go beyond cost causality:

> The historical common law approach for public utility regulation has been that consumers with similar cost profiles are to be treated equally so far as reasonably possible with respect to the rates paid for services. See, for example, *St. Lawrence Rendering Co. Ltd. v. The City of Cornwall,* [1951] O.R. 669-685 at 683; *Chastain et al. v. British Columbia Hydro and Power Authority* (1972), 32 D.L.R. (3d) 443 at 454 (B.C.S.C); *Canada (Attorney General) v. Toronto (City)* (1893), 23 S.C.R. 514 at 519-520.
>
> 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. Objective #2 therein speaks to protecting "the interests of consumers with respect to prices."
>
> The "cost of service" determination will establish a benchmark global amount of revenues resulting from an estimated quantity of units of natural gas or electricity distributed. The Board could use this determination to fix rates on a cost causality basis. This has been the traditional approach.
>
> However, in our view, the Board need not stop there. Rather, the Board in the consideration of its statutory objectives might consider it appropriate to use a specific "method or technique" in the implementation of its basic "cost of service" calculation to arrive at a final fixing of rates that are considered "just and reasonable

> rates." This could mean, for example, to further the objective of "energy conservation", the use of incentive rates or differential pricing dependent upon the quantity of energy consumed. As well, to further the objective of protecting "the interests of consumers" this could mean taking into account income levels in pricing to achieve the delivery of affordable energy to low income consumers on the basis that this meets the objective of protecting "the interests of consumers with respect to prices.
>
> The Board is engaged in rate-setting within the context of the interpretation of its statute in a fair, large and liberal manner. It is not engaged in setting social policy. [32]

4.16 Perhaps the most far-reaching decision associated with the interplay between rate setting powers and statutory objectives arose in the Supreme Court of Canada Decision in *Bell Canada v. Bell Aliant Regional Communications*.[33] In that case, the powers of the Canadian Radio-Television Telecommunications Commission (CRTC, "the Commission") to set just and reasonable rates to accomplish the statutory objectives of the *Telecommunications Act* [34] were confirmed and enhanced.

4.17 The CRTC had ordered deferral accounts set up by incumbent local exchange carriers (ILECs) to record money from excess rates charged to local telephone subscribers. Such over-collections had arose as a result of the application of the annual price cap formula established to set local rates that generated a credit for the rate-paying local subscribers.

4.18 The Commission decided that rather than refund the excess to the ratepayers (to avoid under-cutting local telephone competition), it would order that the money be spent by the ILECs on the extension of broadband service to rural and remote areas of their territories. The SCC affirmed the ability of the CRTC to divert deferral account funds arising from local telephone rates to expansion of broadband service notwithstanding the mismatch of users and services. This was

[32] Ibid at paras 51-56
[33] Bell Canada v. Bell Aliant Regional Communications [2009] S.C.R 764
[34] Canadian Radio-television and Telecommunications Commission Act (R.S.C., 1985, c. C-22) as amended

done despite the fact that broadband services had been previously forborne from regulation.

4.19 In so doing, the judgment noted that sec. 7 of the *Telecommunications Act* included among an extensive list of objectives the goals of:

> a) to facilitate the orderly development throughout Canada of a telecommunications system that serves to safeguard, enrich and strengthen the social and economic fabric of Canada and its regions;
> b) to render reliable and affordable telecommunications services of high quality accessible to Canadians in both urban and rural areas in all regions of Canada;
> c) to enhance the efficiency and competitiveness, at the national and international levels, of Canadian telecommunications;
> f) to foster increased reliance on market forces for the provision of telecommunications services and to ensure that regulation, where required, is efficient and effective;
> g) to stimulate research and development in Canada in the field of telecommunications and to encourage innovation in the provision of telecommunications services;
> h) to respond to the economic and social requirements of users of telecommunications services;

4.20 As well, the Court referenced sec. 47 of the *Telecommunications Act* that provided:

> 47. The Commission shall exercise its powers and perform its duties under this Act and any special Act
> (a) with a view to implementing the Canadian telecommunications policy objectives and ensuring that Canadian carriers provide telecommunications services and charge rates in accordance with section 27;

4.21 The statutory objectives of the *Telecommunications Act* were thus given operational effect in enabling the accomplishment of capital programs for unregulated telecommunications services, from rates paid for regulated local telephone services that were not related to the unregulated services to be provided by the funded broadband expansion.

> A central responsibility of the CRTC is to determine and approve just and reasonable rates to be charged for telecommunications services. Together with its

> rate-setting power, the CRTC has the ability to impose any condition on the provision of a service, adopt any method to determine whether a rate is just and reasonable and require a carrier to adopt any accounting method. It is obliged to exercise all of its powers and duties with a view to implementing the Canadian telecommunications policy objectives set out in s. 7. [35]

4.22 In the result, considerable deference was to be afforded to the Commission in the exercise of its rate-making powers exercised with its statutory objectives in mind:

> In my view, therefore, the issues raised in these appeals go to the very heart of the CRTC's specialized expertise. In the appeals before us, the core of the quarrel in effect is with the methodology for setting rates and the allocation of certain proceeds derived from those rates, a polycentric exercise with which the CRTC is statutorily charged and which it is uniquely qualified to undertake[36].

4.23 The cost causality element of rate setting was thus not the determining factor in the disposition of funds over-collected from local rates:

> As previously noted, the deferral accounts were created and disbursed pursuant to the CRTC's power to approve just and reasonable rates, and were an integral part of such rates. Far from rendering these rates inappropriate, the deferral accounts ensured that the rates were just and reasonable. And the policy objectives in s. 7 □, which the CRTC is always obliged to consider, demonstrate that the CRTC need not limit itself to considering solely the service at issue in determining whether rates are just and reasonable. The statute contemplates a comprehensive national telecommunications framework. It does not require the CRTC to atomize individual services. It is for the CRTC to determine a tolerable level of cross-subsidization.[37]

4.24 Given the strenuous nature of some submissions in the within proceeding that strict cost of service rules must always apply, It bears repeating that in the *Bell Aliant* case that local telephone regulated rates were used to subsidize the unregulated operations of the ILECs to serve telecommunications objectives under sec. 7 of the *Telecommunications Act.* While it might be difficult to hypothesize a precise equivalent circumstance occurring under the OEB Act, it would be as if the Board, concluding that there was a need for more Ontario natural gas storage development, decided to allocate a PGVA balance favourable to ratepayers to the

[35] Ibid at para 36l
[36] Ibid at para 38
[37] Ibid at para 72

LDC to construct its own unregulated gas storage outside of rate base without compensation to ratepayers.

Limitations on Board approach to enabling uneconomic expansion

4.25 In VECC's view, the foregoing clearly validates, in a jurisdictional sense, the Board's approach to date in enabling natural gas service expansion, although this approach imposes some upward pressure on rates paid by existing customers, provided there is no undue burden on customers. It likely falls squarely within the acceptable parameters of judicial interpretation of the ambit of rate-setting powers, set by the statutory objectives mandated to the regulator.

4.26 VECC would submit that the inquiry into whether there is a Board ability to liberalize the criteria for expansion of natural gas service through subsidization from rates paid by existing customers must begin with an exploration of the broad public interest associated with any policy change or new individual project approval.

4.27 This does not mean that the quantum of contribution that might be required from ratepayers is not a significant factor in the determination of the public interest, along with such other concerns as the desirability of competition, appropriate allocation of costs, risks and benefits, environmental impacts, and efficiency.

4.28 In VECC's view, the attempt by the LDCs to quarantine subsidies from rates paid by their own franchise ratepayers to their own community expansion projects may have its real basis in the desire to build rate base that might be hampered by an industry- wide funding mechanism. The LDC position appears to lack statutory or precedential support and, as we have noted elsewhere, has little appeal from a public interest standpoint.

4.29 As was set out in the evidence of Messrs. Hariton and Ladanyi filed herein:

> Without dealing with or setting the appropriate terms and conditions for the establishment of funding similar to the telecommunications model to subsidize uneconomic natural gas expansion discussed elsewhere in this evidence, there would appear to be considerable case law support for the existence of jurisdiction in the OEB to provide for the same if thought necessary. To be thought necessary, such funding would have to be in fulfillment of the statutory objectives provided in sec. 2 of the Act. The relevant objectives contained therein could possibly include: the protection of the interests of consumers with respect to prices and the reliability and quality of gas service (sec. 2. (2)); the rational expansion of the distribution system sec 2(3)); the promotion of energy conservation and energy efficiency in accordance with the policies of the Government of Ontario, including having regard to the consumer's economic circumstances; and the facilitation and the maintenance of a financially viable gas industry for the transmission, distribution and storage of gas (sec. 2(5.1)).[38]

4.30 As the balance of VECC submissions will show, the telecommunications model for funding in areas uneconomic to serve is one option that may be available to the Board together with any terms that may have be recommended to condition access to the model.

4.31 It is, however, a considerable stretch to exclude consideration of potential changes to natural gas expansion policies financed by other than the current EBO 188 policy on the basis of lack of statutory authority.

5. PRINCIPLES OF SUBSIDIZING CUSTOMER ACCESS

Picking winners and losers

5.1 A number of parties who have intervened in this case have business interests that will be affected by the Board's decision. In our submission, the Board needs to weigh the submissions of those parties carefully and determine whether the state of the market for home heating services in the target communities means that

[38] "Natural Gas System Expansion and Subsidies in Telecommunications", Evidence of George Hariton and Tom Ladanyi, March 21, 2016, p.36

subsidized entry of natural gas service by monopoly regulated LDCs is, or is not, required. While it is at least unclear whether natural gas and other alternatives such as propane are in the same product market from a competition economics standpoint, it is also apparent that any subsidized entry may have an effect on existing and potential energy providers. Natural gas expansion should create economic value in a community not just eliminate an alternative and potential economic value.

5.2 Communities which are well served by alternatives to electricity have infrastructure that has been developed over the years to serve these communities. These parties stand to lose significant amounts if the Board undermines basic market fundamentals by allowing subsidies.

5.3 Additionally, the Board may have to ask the question- which communities should be winners and which should be losers? Should the winners be only those communities which are fortunate enough to be chosen by the incumbent utility as a Community Expansion project? An obvious example is service along Ontario Highway 17 between Sault St. Marie and Thunder Bay. Because the TransCanada mainline follows the alternative northern route along Highway 11, these communities have remained largely unserved by natural gas. Why is it not a better use of customers' subsidies, if they are to be compelled, to fill this gap in the natural gas infrastructure in Ontario?

5.4 There has been no detailed exploration in this proceeding of the economic benefits of serving this major part of northern Ontario. Instead those communities approached by Union or Enbridge (or approaching them) have found themselves before the Board. This may be an optimum political outcome, but it does not exhaust the economic options.

5.5 If subsidies are to be paid out based upon societal or other public interest benefits then it is incumbent on the Board, if it means to compel subsidies from existing ratepayers, to determine the optimal use of those expropriated funds.

5.6 However, if the long standing principle of the public interest is to trump cost causality, why could societal and economic benefits to individual customers not be optimized by providing subsidies to low-income customers in currently served areas who cannot afford to convert to natural gas?

Subsidies if necessary should be transparent

5.7 We agree with the with the evidence of Mr. Yatchew with respect to the optimal way for subsidies to be collected and administered:

> 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.[39]

5.8 However, we also realize that this optimal solution may not be instituted by the Government. The second best solution, in our submission, is a universal fund, administered by the Board and with contributions from all rate regulated natural gas distribution utilities. We believe that such a fund is within the authority of the Board to establish.

6. RISKS OF UNECONOMICAL NATURAL GAS EXPANSION

Cross Subsidies vs. Subsidies

6.1 The Board is charged with setting just and reasonable rates. As noted above, currently subsidies from existing ratepayers are allowed as "reasonable" if they don't impose an undue burden. However, we do not think the Board should now adopt exemptions to EBO 188 simply based on the conclusion that the costs are diminutive. It is all too easy to "nickel and dime" captured customers of regulated

[39] Yatchew, pg.12

monopoly utilities. Ontario's electricity customers have been subject to a plethora of social policy initiatives and programs that individually have minimal impact, but taken together turn out to have a material rate impact. These increases are particularly difficult for low-income customers.

6.2 As we have noted, the Board's powers are far reaching when it comes to fashioning rates to meet public interest objectives pursuant to the *OEB Act*. Our view is that the Board can compel customers to subsidize non-economic system expansion. The question is - is this justifiable?

6.3 During the proceeding, a number of parties suggested that cross-subsidies are inherent in ratemaking. This is only true in the strict sense that individual customers do not have distinct tariffs, even though the cost to serve any two customers is unlikely to be identical. Rate classification is the process by which the issues of intra class cross-subsidization is addressed. Cost allocation attempts to address, however imperfectly, inter class cross-subsidy. In this way, it is axiomatic to say that all issues of cross-subsidization have been addressed once all rate classes are determined, and cost allocation methodologies completed.

6.4 Cross-subsidization should be distinguished from subsidies. Subsidies are amounts collected from customers for investments which cannot be profitably sustained. The best example of this is Demand Side Management (and its electricity counterpart Conservation and Demand Management). DSM is a subsidized program in that its costs are greater than the amount any customer would freely pay to purchase the associated services. The actual subsidy is reduced, or eliminated, to the extent DSM programs can lower the utility and consumer natural gas costs than would otherwise be the case.

6.5 DSM also has broader societal benefits. These benefits are difficult to measure because they are not directly priced (i.e. there is no market for clean air) and the benefits are widely dispersed to both gas and non- gas consumers. Since a rational consumer cannot be relied upon to voluntarily pay for programs which do

not provide benefits commensurate with the cost, then any net subsidy must be obtained in the form of increased rates.

6.6 In our view, the Board should approach with caution the issue of compelling consumers of a regulated service to pay subsidies for programs based on societal benefits. Though the objectives of the *OEB Act* are broad the Board's mandate inherently lies in the regulation of monopolies. It is limited by the terms of the *Act* and, although government policy is a lens to assist in any Board focus on the public interest, the expressed non-legislative aspirations of government do not create marching orders for the Board.

6.7 As we have argued above, the Board has broad legal authority within the objectives set out in the *OEB Act*, the departure from cost causality principles as modified by the EBO 188 approach should not be embarked upon by the Board with simply the justification that the rate increase caused by the subsidy is relatively small for the individual existing customer.

6.8 Returning to our earlier point, the public interest is the starting point, and it is not defined solely by a continuum of concern that is wholly satisfied by the fact that only a small rate increase is necessary. It is a decision matrix that includes the elements of consideration including the effect on markets, environmental concerns alternatives to expansion and, as one element, government commitment.

7. ROLE OF GOVERNMENT POLICY

7.1 One of the difficulties in this proceeding is determining the government policy that is being pursued. In the past, when significant investments are to be made government policy has been provided through a directive or changes to governing legislation. The implementation of smart meters is the most obvious example of how the government clearly implements a policy direction. This is not what is before the Board today. The OEB has a clear policy on rational distribution system

planning – EBO 188. There is no clear direction to modify or apply exemptions to this policy.

7.2 In fact, the various facets of current government policy send mixed messages to the Board. Is carbon reduction a priority, or is a priority the expansion of carbon based fuels systems like natural gas? When questioned, both Union and Enbridge foresee announced Government grants and loans for natural expansion to be in addition to their corporate efforts. But there is no evidence this is the intent to the Government. It is equally plausible that the Government believes that its loans and grants can be used within the Board's framework to expand communities where natural gas delivery will provide a net carbon reduction to the community.

7.3 As noted in VECC's sponsored evidence, this is not the first time the Board has considered system expansion in light of government policy. Programs like the Distribution System Expansion Program (DSEP) and the Canada Oil Substitution Program (COSP) were all precursors to changes to Board expansion policy. However, these policies were clear in their efforts to expand natural gas to bring economic development and to displace oil as an alternative fuel.

Cap & Trade and Climate Change Policy

7.4 A cap setting a maximum limit on the amount of greenhouse gas pollution that regulated emitters collectively can produce. Each year, the cap is lowered, requiring industry and other greenhouse gas polluters, such as natural gas distributors and other fuel suppliers, to reduce their emissions. The government notes in this policy that:

> Currently, natural gas combustion and carbon- based electricity emissions from buildings represent per cent of Ontario's climate change- causing air pollution. Because of Ontario's growing population and economy, greenhouse gas pollution

> from its buildings sector continues to rise each year – with no end in sight. Without action in this sector, we will lose the fight to reduce carbon emissions across the economy.[40]

7.5 The Government's announced policy on greenhouse house gas (GHG) emissions has potential implicit conflicts with the announcement of subsidies for natural gas expansion. It implies that uneconomic expansion should only be subsidized where it is clearly demonstrated that the introduction of natural gas will unambiguously reduce carbon emissions.

7.6 The announced GHG policy clearly speaks against the Enbridge proposal of using compressed natural gas (CNG) as an alternative to transmission pipeline access. It is difficult to imagine how replacement of CNG to electricity or propane space heating would be advantageous whether measured on a commercial basis or from the standpoint of societal benefits. In fact, the New Climate Change policy requires all liquid transportation fuels, such as gasoline and diesel, and presumably propane and CNG, slash life-cycle carbon emissions by 5 per cent by 2020.

7.7 The logical outcome of that policy is that, in communities where consumers primarily use electricity or geothermal for space heating, natural gas expansion is questionable. In fact, if carbon reduction is the primary goal then subsidies might be better directed at allowing low-income consumers to upgrade insulation or take other steps to improve the efficiency of existing energy sources.

Role of Government Announced Loans and Grants

7.8 The Ontario Government has yet to announce how grants and loans will be allocated to communities. In the absence of such information it is difficult to understand how the Board would determine a new policy. In the abstract, a number of scenarios are possible. Suppose the Ontario Government determines the goal of system expansion should be in northern Ontario (perhaps along the

[40] Ontario's Five Year Climate Change Action Plan 2016-2020, pg.16

unserved TransCanada highway). What should the Board policy be? On the other hand, suppose the grants and loans are to go to only communities without alternatives to electricity heating. What then should the Board policy be?

7.9 The point is not what will or might happen – rather the point is that it has not happened yet. The OEB should not be trying to read tea leaves. In our submission the Board should wait for the final announcement on how government assistance is to be allocated.

7.10 VECC is also concerned that the Board act in response to "behind the scenes" discussions between the OEB and the Ministry of Energy. The Board is an independent agency with obligations to the *Act* not the Minister. If the Government wishes particular outcomes then it must declare these transparently and provide the necessary direction through the legislative tools available to it. In any event such clarity would minimize missteps between the Government and the OEB failing to be on the same page as to what the policy actually is.

8. PROPOSALS OF THE UTILITIES

8.1 The similarities and differences of the two proposals are set out in the table below:

	Elements of proposal	Enbridge	Union	Comments
1	Revenue surcharge in addition to existing distribution revenue	System Expansion Surcharge(SES) to be charged over 40 years	Temporary Expansion Surcharge (TES) applicable up to a maximum of the first 10 years after in service date of the project	Enbridge proposal provides a better PI, and allows more projects under consideration to go forward.
2	Revenue surcharge rate	$0.23 / m^3	$0.23 / m^3	Same
3	Treatment of revenue surcharge	Revenue	Revenue	Same
4	Municipal tax rebate (ITE)	To be applied over 10 years	To be applied up to 10 years	Enbridge proposal fixed ten years.
5	Community Expansion Portfolio (the "CE Portfolio")	Separate rolling portfolio for defined expansion projects	Projects with PI > 0.4 can go forward	Allows a degree of cross subsidy with the CE Portfolio, more projects under consideration by Enbridge can proceed

From: EGD S3.EGDI.VECC.3

8.2 Under its proposal, Enbridge expects that it could complete approximately thirty nine community expansion projects that would provide natural gas service to approximately 16,000 homes and businesses in the first ten years at a total capital cost of approximately $410 million.

8.3 The forecast average cost per home of connecting the 16,000 homes associated with Enbridge's proposal is $25,625. Based on Union Gas's EB-2015-0179 application which references the connection of 20,000 homes and businesses at a total capital cost of $150 million the average capital cost per customer underpinning.

8.4 The clear difference between the proposals is the inordinate expense of the Enbridge plan as compared to Union Gas. The Board must ask whether these investments are warranted. In our view, such a finding must be made in light of both the energy and carbon emission policies of the Government. Put another way – what would be the societal benefit if instead of the programs suggested by Enbridge, these potential customers were provided a $25,000 subsidy to reduce their energy consumption and carbon emission by investments in energy efficiency equipment, better insulation or other alternative power sources?

8.5 In particular, we find it difficult to understand how providing CNG to communities serves either Government GHG or OEB energy policies.

CIAC or Revenues

8.1 Both utilities have argued that recording funding as revenue rather than contribution in aid of construction is the least cost option. The tables below shows the cross-over points for the Union projects

Figure 1: Revenue Requirement Annually

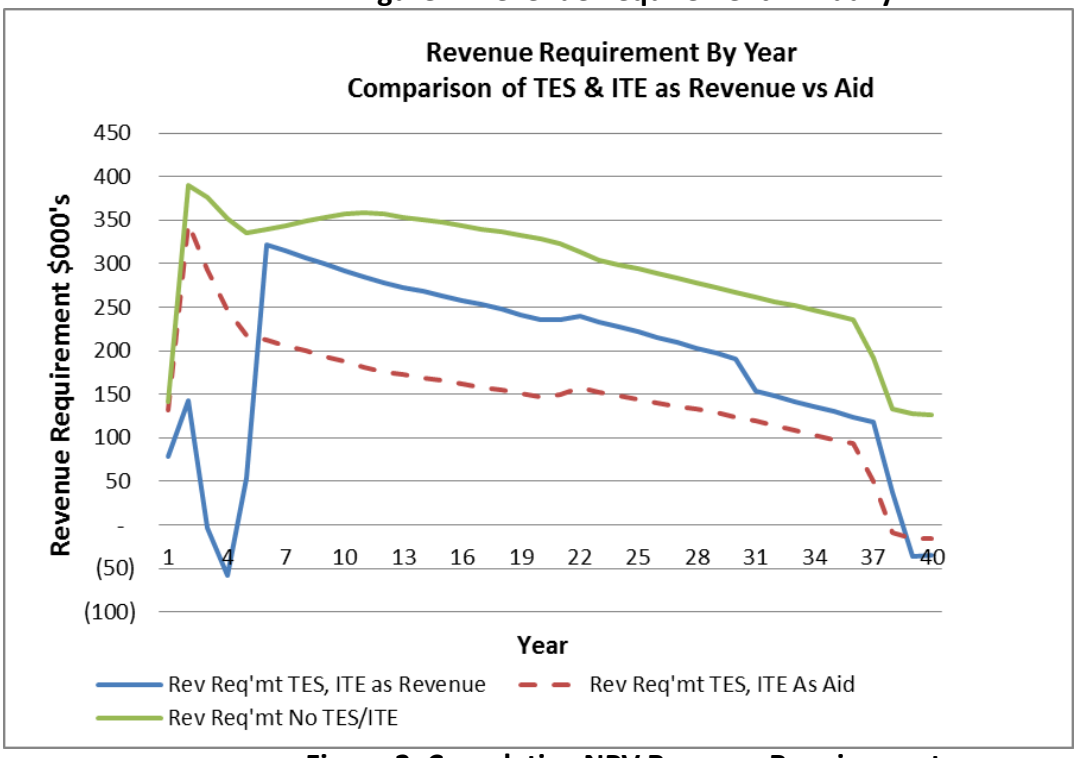
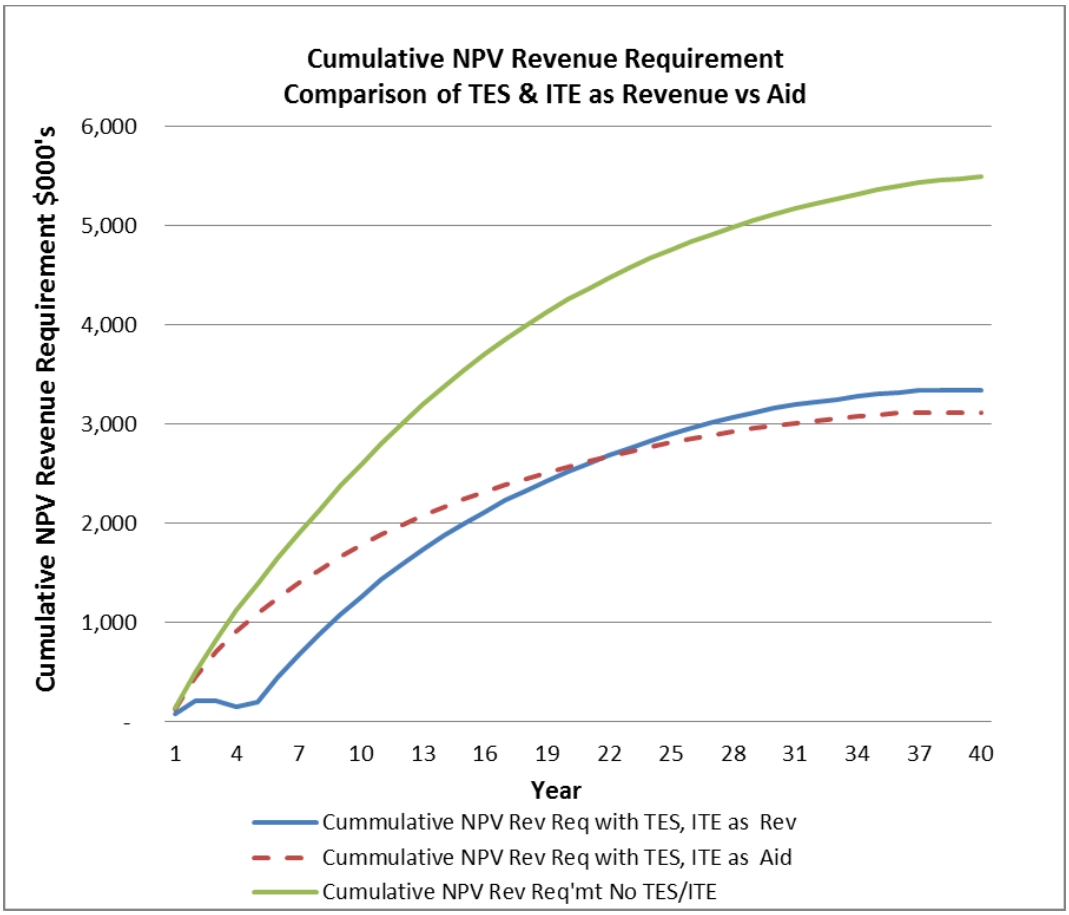


Figure 2: Cumulative NPV Revenue Requirement



Source Exhibit J6.1

8.2 The first observation is that there is only a marginal difference between treatment of funds as contribution in aid of construction (CIAC) or as revenue. While treatment of funds as CIAC is estimated to be slightly better than revenue recording, the real difference is in terms of timing rather than dollars.

8.3 Our second observation is that that the treatment of the funds in revenues rather than CIAC inherently lacks the incentives to minimize capital costs. This is because the utility is rewarded for obtaining a larger rate base.

8.4 Finally, the models presented by the EGD and Union presuppose that the capital funding occurs over a prolonged time period. Under VECC's preferred generation funding model - a universal fund, capital contributions could be made in lump sum.

This would likely be the case in any event under the announced government grant and loan policy.

Utility Risk Aversion

8.5 One common feature of both Utilities' proposal is the high level of risk aversion. Their proposal eliminates all avenues of risk. Deferral (or Variance) accounts are used to capture actual from forecast differences, which in combination with the treatment of funds as revenues provides perverse incentives for cost control.

8.6 Because the products represent an insignificant portion of the customer base there is virtually no additional forecast risk in the Community projects. This is especially important since the most recent similar projects have shown a tendency for the Utilities to over forecast customer attachments

9. FRANCHISE COMPETITION

9.1 This proceeding has brought to bear the issue of how a franchise should be awarded. In this case EPCOR and South Bruce municipalities have apparently struck a deal to allow service in the Kincardine area to be provided by EPCOR (or a subsidiary). EPCOR has taken the position that the details of this agreement are not matters to be determined in this proceeding, but in the Franchise Application. However, the issue of whether franchises should be subject to competition is a matter raised by EPCOR in its sponsored evidence.[41]

9.2 The key point, however, is that competition that is spoken about is competition to own a monopoly franchise[42]. Clearly auctions can maximize revenues from a

[41] See Yatchew, pg.6

[42] It is possible for two, or more entities to be granted the same franchise. In these cases service retains its monopoly characteristic through the issuance of Certificates of Public Convenience. The distinction, however, is more one of form than principle since the Board, using one or both of these vehicles provides monopoly service rights to a utility.

public good. This is often done for other public goods like radio spectrum. In this case, rather than maximizing revenue from the franchise the objective is to have service provided at the lowest cost.

9.3 Once a franchise is granted, and a utility invests in assets to serve that franchise, there is very little likelihood of upsetting that arrangement. In the absence of a voluntary sale authority would be needed to expropriate existing utility assets. To our knowledge no such action has ever been attempted by the Ontario Energy Board in its 50 year history. This means that only unutilized franchise

9.4 While theoretically it is possible for the Board to attempt to extract the "best deal" for consumers through a franchise competition, in practice it is fraught with difficulties. In most cases there is no counterparty to the closest servicing utility. As noted in the VECC sponsored evidence of Hariton and Ladanyi, the last instance of the two incumbent utilities competing head-to-head for a franchise was for the communities of Dundalk, Flesherton and Markdale. In that case, neither utility could convince the Board there was an overwhelming benefit of one provider over the other. The reality is competition for being a service provider is fraught with difficulties since what the Board is really reviewing are forecasts and estimates of costs and the embedded costs of utilities in comparing their rates.

9.5 We do not intend to speak in detail to the apparent agreement between the South Bruce Municipalities and EPCOR. However, we would caution that "side deals" between municipalities and potential service providers "opens up a can of policy worms." Not the least of which is that such a precedent would likely cause existing municipal franchise granters to attempt to abandon the Model Franchise Agreement at times of renewal. The Board, having spent a considerable amount of time and resources working with the utilities and municipalities to implement a uniform approach to franchise renewals would now be pressured to abandon this policy.

9.6 We are also wary of side deals which fall outside the ambit of the Board's utility regulation. For example, would it be permissible for a municipality to negotiate benefits unrelated to utility service? In the vernacular - is the promise of a suitor to build a community center a benefit to be calculated in granting a franchise? We think not. In our view any exception outside that of a ratepayer benefit in the Model Franchise Agreement should be considered carefully.

9.7 In our view, the ITE or property tax credit is one facet that could be considered in the franchise agreement. Such an exemption would have no impact on existing franchises (unless the incumbent utility sought it). By embedding the credit as part of the franchise agreement the Board would also be able to review and embed the agreement for the length of the franchise.

10. CONCLUSIONS

10.1 Modest liberalization to the current policy would allow some projects to proceed. Projects would proceed on a slower basis than the Community Expansion proposals of the LDCs. However a more paced approach to the issue would be prudent.

10.2 The Board should not proceed until the Government has announced how it intends to allocate the announced resources. If the Board is being responsive to a government objective to bring natural gas service to unserved communities, then it seems realistic that expansion takes place on a case by case basis in accordance with the recommendations herein.

10.3 The Board should provide a report which recommends a rational plan for integration of Government announced loans and grants with current or modified Board rules with respect to system expansion. This report should also address the issue of a universal subsidy fund (similar to the NCF and the rural and remote rate fund in electricity) and the issue of non-OEB rate regulated utilities payment into that fund.

10.4 The Board should allow for “community expansion” short to medium term rate riders (similar to the proposed ITEs) by existing utilities. Greenfield utilities should apply for “just and reasonable” rates in the normal course.

10.5 If a subsidy is to be collected and disbursed, the most efficient way for that to be done is through a universal fund which collects the subsidy from all Ontario natural gas customers including those served by the two municipal held gas utilities which are not rate regulated by the OEB.

10.6 Funding from the universal fund, or that allocated by the Government of Ontario should be treated as a CIAC by distributors doing expansion projects]

11. NEXT STEPS

11.1 In VECC’s submission the Board should not grant any exemptions to the current EO 188 policy. Instead, it should order Union Gas and Enbridge to resubmit projects which could be implemented based on:

1. Rolling portfolio of .with a PI of 1.0
2. Implementation of an expansion surcharge for up to 40 years of $0.23 / m3.
3. A revised model franchise agreement which allows utilities to negotiate contributions from municipal government for the extension of service.

12. ANSWERS TO THE BOARD'S ISSUES LIST

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

   VECC has no submission to make on this issue at this time.

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?

   Yes, please see section 4 of this submission.

3. Based on a premise that the OEB has the legal authority described in Issue #1, what are the merits of this approach? How should these contributions be treated for ratemaking purposes?

   The telecommunications regulator's success in funding uneconomic expansion of the telecom network provides a model for the delivery of any subsidy program associated with the uneconomic expansion of natural gas. Any such funding derived from additional rates of existing customers should come from such a fund.

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

   VECC has recommended as a first step that the constraint on the Investment Portfolio be loosened to allow some projects to proceed. If a subsidy is still thought necessary, after the matrix of considerations set out herein is studied, then a universal industry-wide fund should be undertaken.

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?

The Board may wish to consider loosening the IP financial safety feature.

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.

The current rules of EO 188 should be maintained.

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?
N/A

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 the Ontario government has announced a program to financially assist such expansion, qualification for funding would constitute a primary eligibility requirement. The Board must then determine on a case by case basis the need for a subsidy in addition to government funding and apply a public interest test taking into consideration the matrix of considerations including cost/benefit, environmental impacts, impacts on markets, likely penetration rates, allocation of risks and rewards, and overall size of the burden associated with any exemption.

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?

No changes to EBO 188

f) Should the economic, environmental and public interest components in not expanding natural gas service to a specific community be considered? If so how?

Yes. There should not be an automatic formulaic one-size-fits-all approach.

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, with a maximum period of 40 years. The Board should new consider rate classification for these communities

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

No submission at this time

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 submission at this time

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

There should be a requirement to conduct an RFP process by the unserved municipality and the opportunity to negotiate with potential service providers the most favourable terms for ratepayers. The model franchise agreement should ensure a competitive process and/or a transparent description of the quid pro quo for providing service. The latter is particularly necessary where there is only one bidder.

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).

In addition to our response to paragraph 8, there should also be an exploration of alternatives to natural gas and the merits of allowing markets to develop without any subsidized expansion.

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?

It seems difficult to reconcile the policy directions unless the natural gas service expansion policy is considered some kind of exception or outlier justified on the basis of citizen equity. It is up to the government to articulate a more developed rationale.

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?

See above. Eligibility to receive such funding should be the first step in the approval process for uneconomic expansion of natural gas service to unserved communities

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

The Board should not proceed prior to formal notification on the implementation of the Government program(s). See above with respect to the application of any subsidy arrangement.

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