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June 20, 2016

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Our Matter No.: 1171932

Filed via RESS

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

Board File No. EB-2016-0004
Parkland Fuel Corporation ("Parkland") Submissions

In accordance with the Board's Procedural Order No. 3 issued on May 30, 2016, please find enclosed Parkland's submission in the above-noted matter.

The submission is being filed on RESS and two hard copies will be sent to the Board.

Yours truly,

Richard J. King

c: Intervenors in EB-2015-0179 and EB-2016-0004

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Schedule B, as amended ("OEB Act"), and the regulations made thereunder; and

AND IN THE MATTER OF a generic proceeding convened on the Board's own motion under section 19 of the OEB Act regarding the expansion of natural gas service into communities not currently served.

EB-2016-0004

Parkland Fuels Corporation

Final Argument

June 20, 2016

To: Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Summary of Parkland's Main Submissions

1. In developing a regulatory framework for natural gas expansion, the Ontario Energy Board ("OEB" or "Board") should reject the utilities' proposals to have existing customers subsidize expansion to unserved areas, for the following reasons:

   (a) the cost savings evidence of Union Gas Limited ("Union") and Enbridge Gas Distribution Inc. ("Enbridge") clearly shows that no subsidization from existing customers is required;

   (b) subsidization by existing customers would violate the fundamental rate-setting principle of cost causality, since existing customers would receive no benefits from the expansion projects proposed;

   (c) the utilities' proposals place not only the <u>majority of the costs</u> of gas expansion projects on existing customers, but also <u>all of the risks</u> of the expansion projects – and based on recent expansion initiatives in eastern Canada, such risks are real;

   (d) from a regulatory economics perspective, allowing incumbent utilities to roll-in the capital cost of uneconomic expansions is economically inefficient;

   (e) the economic inefficiencies of the subsidy are distortive of competition between these incumbents on the one hand, and new entrants and other fuel suppliers on the other hand (since the latter have to pay market-based prices for capital expansion); and,

   (f) subsidized natural gas expansion into unserved areas will harm and jeopardize the alternative fuel supplier businesses that have invested millions of dollars in rural Ontario to date – these are real costs that the utilities' proposals ignore.

2. Before establishing any generic long-term framework for natural gas expansion, the Board should convene a separate proceeding with a broader scope to:

   (a) consider evidence about alternative methods to finance the time gap between the short-term capital cost requirements of new gas facilities and the long-term expected cost savings – evidence that the utilities failed to provide in this proceeding; and,

   (b) consider the broader question of how best to lower the energy costs in rural and remote communities, which appears to be the real interest of the municipal and First Nation participants in the hearing – without presupposing that natural gas is the preferred option, particularly given that in many areas a vibrant, competitive fuel market exists, without the stranded asset risk unique to natural gas expansions.

Introduction

3. On February 17, 2015, the Ontario Minister of Energy wrote to the OEB encouraging the Board to "examine opportunities to facilitate access to natural gas services to more communities".[1] The Minister's letter did not identify any expansion requirements (e.g., connect a certain number of customers or communities within a certain time frame, etc.) nor did it suggest that expanding natural gas service to additional communities would require subsidization.

4. The very next day, the OEB issued a letter[2] requesting parties with the appropriate financial and technical expertise to propose one or more plans for natural gas expansion. In that letter, the Board made it clear that it would consider a wide variety of approaches, but directed all proponents to take into consideration the following four factors:

   (a) in areas where no certificate of public convenience and necessity ("CPCN") had previously been granted, the Board would consider applications from all proponents with the requisite financial and technical expertise and experience;

   (b) <u>proposals should be cost effective and incorporate flexibility with respect to cost recovery (e.g., ROE, depreciation period, recovery of capital contribution, etc.)</u>;

   (c) proposals should include measures that foster predictablity and cost certainty for consumers; and,

   (d) proposals for new expansion projects should minimize impacts on existing natural gas ratepayers. (emphasis added)

5. Instead of heeding the Board's request to canvas all options to expand natural gas service, and allowing the Board to determine a preferred approach, Union and Enbridge simply advanced subsidy-based proposals designed to connect the maximum number of communities, with the majority of costs and all risks borne by existing customers. In a similar vein, EPCOR's expert evidence was prepared on the assumption that subsidization would occur, and focused solely on the best form of subsidy.[3] That evidence did not consider whether subsidies were in fact required or appropriate, or if another funding mechanism might be a preferable approach.

[1] EB-2015-0179, *Application of Union Gas Limited – Expansion of Natural Gas Distribution* ("Union Application"), Exhibit A, Tab 1, Appendix A, p.1.

[2] Union Application, Exhibit A, Tab 1, Appendix A, p.2-4.

[3] EB-2016-0004, *Hearing Transcripts* ("Transcript"), Vol.6, p.188, line 24 to p.189, line 4.

6. As a result, the full scope of potential options available to expand natural gas service have not been discussed, despite the voluminous record in this proceeding. Union and Enbridge have not explored different options[4], including:

   (a) alternative financing options;[5]

   (b) the willingness of municipalities to bear additional costs;[6]

   (c) mechanisms with higher Stage 3 benefits;[7]

   (d) lowering their return on equity ("ROE");[8] or

   (e) altering or suspending depreciation expense recovery.[9]

7. These last two items (flexibility with respect to cost recovery via an alternate ROE or depreciation period) were explicitly stated by the Board to be included in expansion proposals[10] - presumably because the Board understands that a key barrier to gas expansion is the time lag in utility cost recovery of significant upfront capital costs.

8. Enbridge and Union acknowledged this – Enbridge agreed that the economic barrier to natural gas expansion today is really the time gap between the short-term capital cost requirements of new gas facilities and the long-term expected cost savings.[11] Similarly, Union testified that the biggest barrier to expansion today is customers' unwillingness to cover the upfront costs of gas expansion.[12]

9. Based on the utilities' projected cost savings, this is a financing issue – not a situation that warrants subsidization.

10. Yet the utilities are unwilling to consider different financing options to bridge the difference between the upfront capital investment and the long-term savings. Instead, their

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[4] Transcript, Vol. 1, p.29, line 28.

[5] Transcript, Vol. 5, p.122, lines 24-28.

[6] Transcript, Vol. 1, p.52, lines 1-3; p.157, lines 14-15.

[7] Transcript, Vol. 3, p.7, line 5.

[8] Transcript, Vol. 1, p.29, line 16 to p.30, line 10; EB-2015-0179, Exhibit B.Staff.3(i).

[9] Exhibit s15.Union.LPMA.5(c).

[10] Union Application, Exhibit A, Tab 1, Appendix A, p.4.

[11] Transcript, Vol. 1, p.226, line 17.

[12] Transcript, Vo. 5, p.125, lines 2-4.

proposals (based on having existing customers subsidize the costs and assume the risks) were justified on the basis that the rate impacts on existing customers are "reasonable".[13]

11. This is not a principled approach to funding system expansions. It is not principled from an economic perspective, it is not consistent with the Board's mandate that rates be just and reasonable (since it violates the fundamental rate-setting principle of cost causation), and it is not consistent with the statutory objectives of the Board (including that gas distribution system expansion be rational).[14]

12. It is easy to raise large sums of money by simply increasing the Union or Enbridge delivery charge a little bit, given the size of the two utilities' customer bases. But that does not mean this Board should permit the utilities to do so, if it means abandoning sound economic principles and the most fundamental rate-making principles.

13. At a minimum, Parkland is of the view that the Board needs to have better evidence about other possible financing options (other than simple reliance on existing customer subsidization) in order to establish a long-term framework for gas expansion.

14. It is critically important that the regulatory framework ultimately established by the Board is one that best meets the needs of the province in the fairest, most economically efficient manner possible. The potential cost and risk implications for Ontarians are significant. The framework will not just apply to the specific projects being proposed by Union and Enbridge – there could be many more projects in the future.[15] According to NOACC, there are hundreds of additional communities that would seek to connect to natural gas if a subsidy for natural gas expansion were approved.[16] Union similarly suggested that many more projects (beyond those included in EB-2015-0179) would be possible with additional subsidization or government funding.[17]

15. In addition to the costs of these expansion projects are significant risks. These risks include: (a) the risk of capital cost overruns on the expansion projects; (b) the risk of conversion rates to natural gas being less than forecasted by the utilities; and (c) the risk of customers converting away from natural gas in the future. Recent experiences elsewhere in Canda have shown that thse risks are very real.[18] Under the utilities' proposals, existing

[13] Transcript Vol. 1, p.26, line 28 to p. 27, line 2.

[14] See OEB Act, sections 2 and 36.

[15] Transcript, Vol. 1, p.211, line 8.

[16] Transcript, Vol. 4, p.21, line 16.

[17] Transcript, Vol. 4, p.178, lines 23-25.

[18] See, for example, KPMG study – *Jurisdictional Review of Natural Gas Distribution System Expansions*, March 31, 2015, prepared for Ontario Energy Board, in CPA Evidence at Exhibit 8, Tab 8, p.34.

customers will be required to bear these risks, despite the fact that they receive no benefit from expanding natural gas to new communities.

16. So the costs and the risks associated with the establishment of the framework are far more significant than what is before the Board in the current proposals. The utilities cannot legitimately say that the rate impacts on existing customers will be "reasonable."

17. What became apparent as the proceeding unfolded was that different parties seem to have different understandings about the purpose of the proceeding and the provincial government's direction. Should the purpose of this proceeding simply be about, as the utilities would suggest, expanding natural gas to the most communities possible with minimal impacts to ratepayers (i.e., presupposing that natural gas is the preferred fuel source)?[19] Or should it be about reducing energy costs in rural and remote communities, which appears to be the real interest of the rural and remote communities that participated in the hearing? Depending on how this purpose is framed, different options may be available. For example, alternative fuel sources such as propane or geothermal may be able to achieve the same cost savings in rural or remote communities at a lower cost. However, Union's evidence is that even if alternative fuel sources can meet this objective at a lower cost, natural gas should be favoured.[20]

18. Parkland recommends that, prior to establishing a long-term framework for gas expansion, the OEB clearly articulate the purpose of encouraging natural gas expansion (particularly in areas where robust alternative fuel competition already exists) and provide explicit direction to all parties on the evidence that it requires to develop a long-term framework to meet that purpose. Unfortunately, given the different understandings of the different parties and the compressed timing of this proceeding, we simply do not have the right information today to allow the Board to fully understand and consider all possible options to ensure natural gas expansion occurs in a manner that best meets the needs of the province.

19. In the interim, natural gas expansion will continue at the same healthy rate that it has in the past several years.[21]

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[19] This is clearly the approach the utilities have taken, because the projects put forward do not even remotely come close to trying to adhere to principles of cost causation, economic efficiency or the statutory objective of rational expansion. Leading up to this proceeding, Union's own internal steering committee proposed dropping the project PI to 0.6, stating that pushing the PI threshold below 0.6 would result in a heightened risk for existing ratepayers. Union's ultimate proposal ignred that cautionary note from their internal sttering committee, and proposed a PI threshold of 0.4. Transcript, Vol. 6, p.115, line 26 to p.118, line 27. Enbridge did not even propose a limit to how uneconomic projects can be.

[20] Transcript, Vol. 5, p.191, lines 3-10.

[21] Exhibit S12.Parkland.FRPO.2.

20. In the alternative, if the Board establishes a long-term framework in this proceeding, that framework should require the Board to convene a competitive process[22] for the franchise and CPCN rights in expansion areas, which process should include:

    (a) an explicit prohibition on the use of subsidies from existing customers as a means of covering the capital costs of the expansion;

    (b) evaluative criteria that require the proposals to establish the need for the expansion project, based on evidence that includes:

        (i) the existing levels of competition among existing fuel suppliers in the region; and,

        (ii) the existing level and cost of existing service being provided by existing fuel suppliers.

    (c) evaluative criteria that give preference to:

        (i) utilities willing to take some of the risks associated with the expansion project, such as a lower ROE for a period of time, or tying their ROE to risks associated with cost overruns, customer conversion rates, and customer retention rates;

        (i) municipalities or other levels of government willing to contribute to the capital cost of the expansion project, or share in the risks noted above;

        (ii) the utilities' proposals for rates for the newly served area (including any surcharges); and,

        (iii) proposals with minimal costs and risks to existing fuel suppliers (i.e., loss of business, employment, etc.).

<u>Issue 1</u>: What is considered a community in the context of this proceeding?

21. Parkland submits that there is little or no value in setting a minimum community size. Expansion proposals should be evaluated on the basis of sound economic and rate-making principles, and a consideration of the existing competitive market conditions in communities where expansion is proposed.

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[22] See discussion under Issue 9, below.

Issue 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?

22. This issue is one of legal jurisdiction. For the reasons that follow, Parkland respectfully submits that the Board does not have the legal authority to establish a framework whereby the customers of one utility subsidize expansions undertaken by another utility.

23. The Board's mandate for economic regulation is "rooted in the achievement of economic efficiencies, the establishment of fair returns for natural monopolies and the development of appropriate cost allocation methodologies."[23] This mandate is set out in section 36 of the OEB Act, which provides that: (a) no gas distributor can charge its customers for the distribution of gas except in accordance with an order of the Board;[24] (b) the Board is empowered to make orders approving or fixing "just and reasonable" rates for distributing gas;[25] and, (c) the Board is authorized to employ "any method or technique that it considers appropriate" to fix "just and reasonable rates."[26]

24. The OEB Act states that the Board shall be "guided" by a list of objectives in carrying out its mandates, including, *inter alia*: (a) the protection of the interests of consumers with respect to prices and the adequacy, reliability and quality of gas service; (b) the facilitation of rational expansion of transmission and distribution systems; and (c) the facilitation of the maintenance of a financially viable gas industry.[27]

25. When attempting to interpret a statutory provision, the Supreme Court of Canada has indicated that the words of a statute are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the statute, the object of the statute, and the intention of the legislature.[28]

26. Parkland submits that based on rules of statutory interpretation, the OEB Act does not provide the Board with the jurisdiction to permit inter-company subsidization through its rate-making authority. Parkland acknowledges that the Board's power in respect of setting just and reasonable rates is to be interpreted broadly, and extends well beyond a strict construction of the task.[29] However, as noted by the Ontario Court of Appeal, the breadth

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[23] *Advocacy Centre for Tenants-Ontario v Ontario Energy Board,* 293 DLR (4th) 684; [2008] OJ No 1970 (QL), para 38 ("*Tenants*").

[24] OEB Act, s. 36(1).

[25] OEB Act, s. 36(2).

[26] OEB Act, s. 36(3)

[27] OEB Act, s. 2.

[28] See Ruth Sullivan, *Sullivan on the Construction of Statutes*, 6th ed (Toronto: LexisNexis Canada Inc., 2014) at 7 [emphasis added].

[29] *Toronto Hydro-Electric System Limited v Ontario Energy Board,* 2010 ONCA 284, para 25 ("*THESL*").

of the Board's rate-setting power extends only to actions that are "in furtherance of the statutory objectives."[30]

27. In *Tenants*[31], the Ontario Superior Court of Justice found that the OEB has the jurisdiction to establish a rate affordability assistance program for low income consumers purchasing the distribution of natural gas from the utility.[32] However, the Court in *Tenants*[33] noted that "the power granted to a regulatory authority 'must be exercised reasonably and according to the law, and cannot be exercised for a collateral object or an extraneous and irrelevant purpose, however commendable.'"[34] In finding that the Board has the jurisdiction to take into account the ability to pay in setting just and reasonable rates, the Court concluded that this finding complies with the Board's mandate to fix "just and reasonable" rates, promotes the legislated objectives in the OEB Act, and leads to a reasonable and just outcome.[35]

28. Based on the facts in this proceeding, Parkland submits that the finding of jurisdiction in *Tenants* is entirely distinguishable from the issue at hand which seeks to address subsidization between a regulated company and the customers of another regulated company. The Court in *Tenants* stated that with respect to the OEB's power to set just and reasonable rates, "cost of service is the starting point building block in rate setting, to meet the fundamental concern of balancing the interests of all consumers with the interests of the natural monopoly utility.[36] Furthermore, the Court in *Tenants* held that "so long as the global amount of return to the utility based upon a 'cost of service' analysis is achievable, then the rates/prices (and the methods and techniques to determine those rates/prices) to generate that global amount is a matter for the Board's discretion in its ultimate goal and responsibility of approving and fixing 'just and reasonable rates.'"[37] While *Tenants* suggests that the Board has wide discretion in terms of allocating a utility's costs among its customers, it reinforces the view that rates for a utility's customers should be based on that utility's cost of serving those customers. Requiring a utility to calculate rates for its

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[30] *THESL*, para 26.

[31] *Tenants*.

[32] *Tenants*, para 68.

[33] Citing *Re Multi Malls Inc. et al and Minister of Transportation and Communications et al.,* 14 OR (2d) 49 at 55 (CA).

[34] *Tenants*, para 58 [emphasis added].

[35] *Tenants*, para. 62.

[36] *Tenants*, para. 58.

[37] *Tenants*, para 59.

customers based in part on the costs of another utility's expansion projects significantly deviates from this cost of service model.

29. Further, inter-utility subsidies are not contemplated or supported by the objectives in section 2 of the OEB Act. One of the central objectives in the legislation is to protect "the interests of consumers with respect to prices".[38] As stated in *Union Gas Ltd. v Ontario (Energy Board)* "it is the function of the OEB to balance the interest of the appellant [company] in earning the highest possible return on the operation of its enterprise (a monopoly) with the conflicting interest of <u>its customers</u> to be served as cheaply as possible."[39] It is not the function of the OEB to balance the interests of one company with the conflicting interest of another company's customers.

30. Section 2 of the OEB Act also speaks to facilitating "rational expansion of transmission and distribution systems", Parkland submits that this objective should be interpreted together with the remainder of the Act and should not be used to undermine the other legislated objectives.

31. For these reasons, absent amendments to the OEB Act to expressly allow inter-utility subsidies, Parkland submits that the Board has no legal jurisdiction to implement a framework whereby the customers of one utility subsidize expansion projects undertaken by another utility. Parkland submits that the Board's history of setting rates based on the utility's cost of service is in keeping with the Board's objectives under the OEB Act and reflects the core principles upon which the OEB must determine "just and reasonable rates".

32. As stated by the Court in *Tenants*, "[t]he Board is engaged in rate-setting within the context of the interpretation of its statute in a fair, large and liberal manner. <u>It is not engaged in setting social policy</u>." Furthermore, the Court in *Tenants* held that the Board is an economic regulator, rather than a formulator of social policy.[40] Developing a framework that not based on the utility's cost of service and that does not protect the interests of consumers with respect to prices is an exercise that is best left to the legislature as it is a matter of public policy.

33. The Board has no legal authority to permit inter-company subsidies under the current wording of the OEB Act.

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[38] OEB Act, s. 2(2).

[39] 43 OR (2d) 489 at p 11 (Quicklaw).

[40] *Tenants*, para 49.

Issue 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 contrbiutions be treated for ratemaking purposes?

34. Even if it was determined that the OEB had the legal authority to establish a framework whereby the customers of one utility subsidize the expansion costs of another, based on the evidence in this proceeding, there is no need or merit in permitting such subsidization to occur. Indeed, the evidence clearly shows that no subsidization of any kind (intra-utility or inter-utility) should form part of the Board's legal framework for natural gas expansion.

35. Parkland's argument regarding subsidization generally is set out under Issue 4(a) below.

Issue 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 project that have a portfolio profitability index (PI) less than 1.0 and individual projects within a portfolio that have a PI lower than 0.8?

(b) What costs should be included in the economic assessment for providing natural gas service to communities and how are they to be determined and calculated.

(c) What, if any, amendments to the EBO 188 and EBO 134 guidelines would be required as a result of the inclusion of any costs identified above?

(d) What would be the criteria for the projects/communities that would be eligible for such exemptions? What, if any, other public interest factors should be included as part of this criteria? How are they to be determined?

(e) Should there be exemptions to certain costs being included in the economic assessment for providing natural gas service to communities that are not served? If so, what are those exemptions and how should the OEB consider them in assessing to approve specific community expansion projects?

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

36. Parkland submits that the evidence in this proceeding clearly shows that no exemption to the portfolio or individual project PI is required or merited. In the alternative, if the Board is inclined to permit exemptions from the current PI thresholds for expansion projects or portfolios, the Board should restrict any such exemptions to individual project PIs and continue to require portfolio PIs of 1.0.[41]

[41] Union acknowledged that if the project-specific PI threshold was reduced (but rolling portfolio left at 1.0) and its proposed surcharge was applied "a few projects each year" could proceed without changing the rolling project

37. There are a number of reasons that support Parkland's arguments, including:

(a) the cost savings evidence of Union and Enbridge clearly shows that no subsidization from existing customers is required;

(b) subsidization by existing customers would violate the fundamental rate-setting principle of cost causality, since existing customers would receive no benefits from the expansion projects proposed;

(c) the utilities' proposals place not only the majority of the costs of gas expansion projects on existing customers, but also all of the risks of the expansion projects – and based on recent expansion initiatives in eastern Canada, such risks are real;

(d) from a regulatory economics perspective, allowing incumbent utilities to roll-in the capital cost of uneconomic expansions is economically inefficient;

(e) the economic inefficiencies of the subsidy are distortive of competition between these incumbents on the one hand, and new entrants and other fuel suppliers on the other hand (since the latter have to pay market-based prices for capital expansion);

(f) subsidized natural gas expansion into unserved areas will harm and jeopardize the alternative fuel supplier businesses that have invested millions of dollars in rural Ontario to date.

38. Each of these reasons is discussed in turn.

Cost Savings Assertions by Enbridge and Union

39. If the utilities' cost savings evidence is correct, and the actual cost savings to expansion-area consumers substantially exceed the expansion costs,[42] then no subsidy is required.

40. For instance, Enbridge's own evidence suggests that its proposed expansion projects have a shortfall of $123 million in capital funding (i.e., a poor PI), which Enbridge is seeking to recover entirely from existing ratepayers. Yet these proposed expansion projects would provide 16,000 new customers with $345 million in energy cost savings benefits (or over $22,000 per customer).[43] Based on these numbers, why should existing customers provide

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portfolio threshold or requiring a subsidy from existing customers (Transript, Vol. 5, p.140, lines 11-14). If the surcharge was applied for 40 years, as proposed by Enbridge, even more projects could proceed (Undertaking J6.5). However, as noted in Parkland's introductory comments, the evidence of the utilities failed to examine this approach – preferring instead to put forward proposals that maximized the number of uneconomic expansions at the expense and risk of existing customers.

[42] See, for example, Table 10 in Enbridge's evidence.

[43] Enbridge Evidence, p.33, Table 10; Transcript, Vol. 1, p.23, line 3 to p.24, line 11.

a subsidy of $123 million so that new customers can receive $345 million in benefits? That $123 million should come from new customers.

41. Union's proposal for 30 projects would provide energy cost savings of $324 million to approximately 20,000 customers at a total cost of approximately $150 million.[44] Again, the question becomes why existing customers should pay for another group of customers to benefit.

42. Gas distributors should have to convince potential customers of the value of switching to natural gas. This is what any new entrant with a different technology faces when seeking to enter a market with its new technology. In unregulated markets, there is no regulator that subsidizes switching to the new technology; rather, it is competing companies themselves that bear the burden (and risk) of educating and convincing customers to switch. There is no justification for using rate regulation to subsidize one particular technology.[45]

43. For these reasons, if the cost savings evidence of the utilities is to be believed, there is no need to facilitate natural gas expansion through subsidies from existing customers. If the barrier to expansion is the time lag between the upfront capital costs and the long-term cost savings – as suggested by the utilities – the solution should be financing to bridge the gap, not subsidies from existing customers.

Violates Principle of Cost Causation – Existing Customers Receive No Benefit

44. The utilities have failed to identify any "benefits" of natural gas expansion for existing customers. Enbridge and Union both made cursory references to "economies of scale" that existing customers would benefit from spreading the utility's fixed costs over a larger customer base.[46] When specifically asked about these benefits, little information was provided by Enbridge, and Union estimated these benefits at only 50 cents per customer per year – well below the expected rate increases for existing customers that result of the expansion projects.[47]

45. Union highlights other benefits beyond new customer cost savings (support local business, increased home values, municipal cost savings at community buildings, new work for

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[44] EB-2015-0179, Union Evidence, p.4, lines 1-3 and p.38, line 5.

[45] Exhibit S12.Parkland.BStaff.4.

[46] Enbridge Evidence, p.7, para.25; Transcript, Vol. 6, p.86, lines 1 to 19.

[47] Exhibit S3.EGDI. Parkland.2.

HVAC business), but to the extent any of these materialize, they all would accrue to the expansion community – not to existing customers.[48]

46. The principle of cost causation is a fundamental principle of rate-making, and provides that approved rates must reflect the costs actually caused by the customer who pays the rates. Regulators and courts evaluate compliance with cost causation principles by comparing the costs assessed against a customer class to the burdens imposed or benefits drawn by that group of customers.

47. The application of the principle is straightforward here – existing customers would be asked to pay rates that: (a) include costs caused by a new group of potential customers; and (b) result in benefits only to those potential new customers. This would clearly violate the cost causation principle.

Existing Customers Bear Not Only Most Costs, But All Risks

48. The utilities have placed great emphasis on the contention that the rate impacts of their expansion proposals on existing ratepayers are reasonable – and bolster this claim by pointing to accepting caps on rate increases to existing customers.

49. With respect, no weight can be given to the utilities' statements on rate impacts. Given the risks being placed on existing customers (see discussion below), estimates of the potential rate impacts are unreliable. Further, an imposition of a rate cap would always be subject to change, particularly if the risks discussed above materialize. The fact is, if a framework is established that puts the risk of these expansion projects solely on existing customers, any costs that materialize will be borne by existing customers.

50. The capital cost risk of the utilities' expansion proposals are significant, and include:

(a) the risk of capital cost overruns on the expansion projects ("Construction Risk");

(b) the risk of conversion rates to natural gas being less than forecasted by the utilities ("Conversion Risk"); and,

(c) the risk of customers converting away from natural gas in the future ("Retention Risk").

51. With respect to Construction Risk, any capital cost overun associated with new expansion projects would be costs borne by the existing ratepayers, not the utilities (or their shareholders), or new customers. Enbridge and Union confirm this, and refuse to take on

[48] Union Evidence, EB-2015-0179, p.12, lines 9 to 19.

this risk notwithstanding that they (unlike existing customers) will obviously benefit from expansion projects.[49]

52. With respect to Conversion Risk, the proposition is straightforward – if the utilities' conversion forecasts are wrong, existing customers bear the burden of the shortfall in revenues.[50] Given that conversion costs will be directly dependent upon estimated cost savings from switching to natural gas, the quality of the utilities' evidence with respect to forecasted cost savings and conversions is critical – and the utility evidence in this proceeding is problematic:

(a) Enbridge's initial evidence stated that switching from propane to natural gas, for example, would result in annual savings of $1,633 (or $1,081 when you take into account Enbridge's proposed surcharge to new customers). But that figure is based on the price of propane in an anomalous year (2014), compared with natural gas prices in a more typical year (2015). Comparing the prices of both fuels in 2015, the annual cost savings were found to be $701 (or $149 when the surcharge was taken into account). Yet Enbridge's conversion forecast is based on the data from 2014.[51]

(b) Enbridge's forecasted conversion rate in expansion communities is 75%, which seems ambitious based on Union's forecasted conversion rate (45%), and Enbridge's experience in other communities in Ontario and in eastern Canada.[52]

(c) Enbridge's forecasted conversion rate in new subdivisions is 100%.[53] This fails to take into account the new incentives, rebates and Building Code changes planned in the Climate Change Action Plan – all of which are geared towards new homes being "near net zero" emissions and new small buildings "net zero" emissions.[54]

(d) Union Gas' estimate of conversion costs (to convert from propane to natural gas) in its evidence is materially less than the estimates provided by the CPA and even Enbridge for conversion. This low cost estimate is the basis for the forecasted

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[49] Transcript, Vol. 1, p.168, line 18 to p.169, line 7 (Enbridge); Transcript, Vol. 6, p.102, line 21 to p.103, line 1 (Union).

[50] Transcript, Vol. 1, p.34, lines 19-26 (Enbridge); Transcript, Vol. 6, p.102, lines 15-18.

[51] Enbridge Evidence, Table 1, para.46; GPMI Evidence for CPA, Figure 1, p.9 of 27; Transcript, Vol. 1, p.163, line 10 to p.164, line 17; Exhibit S3.EGDI.FRPO.8.

[52] Transcript, Vol. 1, p.31, line 9 to p.34, line 18; Exhibit S3.EGDI.EP.7; Exhibit S3.EGDI.BOMA.26.

[53] Transcript, Vol. 1, p.168, lines 3-4.

[54] *Ontario Five-year Climate Change Action Plan (2016-2020)*, sections 4.1, 4.3, 5.1.

conversion rates used by Union Gas in its estimate. By Union's own admission, higher conversion costs could decrease the number of conversions.[55]

53. With respect to Retention Risk, Enbridge confirmed that if a customer converted to natural gas as part of a natural gas expansion project, but within the next 40 years decided to convert away from natural gas, that the existing customers would have to take on the "lost" System Expansion Surcharge.[56]

54. Similarly, Union was asked whether (as a result of government policy on, for example, climate change) existing customers would bear the risk associated with lower utilization (and revenues) – and Union confirmed.[57]

55. The types of expansion projects being considered in this proceeding are long-term investments. Over this time frame, there are considerable uncertainties associated with Ontario's future climate change policies, long-term price differentials between natural gas and alternative fuels, and the development and availability of alternative technologies. Each of these factors could cause customers to convert away from natural gas in the future. The risk of these expansion projects becoming stranded assets will be borne entirely by existing customers.

56. These risks may result in significant additional costs being borne by existing customers in the future.

<u>Subsidization by Existing Customers is Economically Inefficient</u>

57. The current EBO 188 framework, through its minimum target for the Rolling Project Portfolio, is an attempt to balance the pursuit of new economic expansion projects (that might be uneconomic on a stand-alone basis) while minimizing cross-subsidization. This is because economic regulators such as the OEB attempt to set rates that promote economically efficiencies.

58. From an economic efficiency perspective, and to ensure that any gas expansion is "rational" (pursuant to the statutory objective in the OEB Act), the EBO 188 standard should not be relaxed unless there is a compelling demonstration that subsidized expansions are economically justified.

59. Subsidies for natural gas expansion can only be economically justified if such expansions: (a) produce benefits beyond the regions about to receive new gas service; (b) those benefits

[55] Transcript, Vol. 6, p.89, line 25 to p.94, line 16.

[56] Exhibit S3.EGDI.Parkland.4.

[57] Transcript, Vol. 6, p.103, lines 2 to 11.

are specifically linked to natural gas expansion; and (c) the magnitude of these benefits exceed the amount of subsidy provided.[58]

60. The evidence on the record has provided scant evidence of any benefits beyond the rural and remote communities that would receive new gas service. References have been made by the utilities and the municipalities about broader societal benefits (rural job creation and economic development, incremental tax revenue, etc.) but these are just statements without little or no empirical evidentiary support.

61. Other services (telecommunications, highways, railroads, internet, etc.) increase interconnectedness for existing and newly served areas. That is not the case with natural gas. Similarly, incremental environmental benefits of natural gas conversino to the rest of the province are also likely to be very small (if any).

62. As noted in the Dasgupta/Nieberding expert evidence, a National Regulatory Research Institute ("NRRI") working paper describes the hypothesized benefits from natural gas expansion as "so far lack[ing] empirical support, at least in providing policy-makers with reliable evidence that their magnitude is sufficient to warrant government action."[59]

63. Again, the Court in *Tenants* held that the Board is an economic regulator, not a formulator of social policy.[60] There is simply no economic justification for creating a subsidy for natural gas expansion.

<u>Subsidization Distorts Competition with Existing Fuel Suppliers</u>

64. A subsidy from existing customers to new ratepayers to fund uneconomic expansions also distorts competition between the incumbent utilities on the one hand, and alternative fuel suppliers and new entrants on the other hand (since these firms have not received subsidies for their capital expansions).[61]

65. In areas currently unserved by natural gas there is competition (to varying degrees) among incumbent fuel sources such as propane, wood, fuel oil, etc., and this competition occurs on an unregulated basis. Only electricity rates are regulated (and that is because they provide an essential service on a monopoly basis). The fact that the province has not sought to regulate the retail rates of propane in these areas suggests that competition is working in

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[58] Exhibit S12.Parkland.BStaff.3.

[59] Evidence of Kalyan Dasgupta and Dr. Jim Nieberding, p.14, para.4.12.

[60] *Tenants*, para. 49.

[61] Exhibit S12.Parkland.BStaff.3.

the sense that the rates being charged are reasonably well aligned with the underlying costs of providing service.[62]

66. The effect of subsidizing natural gas expansions will be to artificially lower the cost of natural gas for rural consumers to incent those consumers to convert to natural gas from their existing heating fuels. If the utilities achieve the level of conversions they forecast, the effect of this subsidization will effectively be to replace the existing competitive market for heating fuels in these communities with a regulated natural gas monopoly. This is the opposite of the purpose of regulation.

67. The fact of the matter, of course, is that without the subsidy (i.e., if new customers are required to pay what it costs for natural gas), the utilities' proposals fall apart – the "cost savings" provided by natural gas dissipate and the conversion forecasts become meaningless. The only way for natural gas expansion to occur is by distorting mature, well-functioning fuel markets in other areas of the province.

<u>Existing Fuel Suppliers Would Be Significantly Harmed</u>

68. Proponents of relaxing the PI thresholds in EBO 188 (i.e., relying on subsidies from existing customers to support uneconomic expansion) have asserted that there are quantifiable benefits associated with natural gas expansion (i.e., energy cost savings) as well as non-quantifiable benefits associated with natural gas expansion.

69. However, in addition to potential public interest benefits (which based on the evidence accrue almost entirely to new gas customers), the Board has noted that potential public interest <u>costs</u> should be considered as well. These public interest benefits and costs were categorized by the Board in EBO 134 as Stage 2 (quantifiable) and Stage 3 (non-quantifiable) benefits.

70. As noted in Parkland's evidence, the prospect of subsidized, uneconomic expansion of natural gas into unserved areas of Ontario would impose significant costs and very real risks to Parkland's business in this province. Parkland has 17 branches and 264 employees in Ontario, serving 900 mostly rural communities:[63]

> If Union Gas, Enbridge Gas Distribution and other natural gas distributors are permitted to further cross subsidize natural gas prices, then such extra fees paid by the current ratepayers will effectively finance an increase in the penetration rates of the natural gas providers ... Such increase in penetration rates would have material adverse consequences to Parkland and other propane and fuel suppliers in Ontario. For example, Parkland would experience a loss in efficiency which would substantially increase fuel and servicing costs to the remaining propane and

[62] Exhibit S.12.Parkland.BStaff.4.

[63] Affidavit of Gary Highfield, Parkland, paras. 7 and 8.

> fuel consumer base, further harming Parkland's competitiveness in Ontario's fuel markets.
>
> It is likely one or more of the bulk facilities would be consolidated in order to achieve the necessary efficiencies to maintain viable business. This may impact our ability to service certain geographic areas resulting in a loss of competition or perhaps propane service altogether for some communities.
>
> ...Parkland would experience a material loss in profits and business opportunities. Such material loss in profits would cause Parkland to eliminate jobs in the Province of Ontario.
>
> Additionally, the natural gas expansion that results from the cross-subsidization would likely make future investment in rural Ontario uneconomical for Parkland's commercial operations, which would include investments in infrastructure and employment.

71. The replacement value of Parkland's business in Ontario is in excess of $24 million, and Parkland is only one (and not the largest) propane business in the province.

72. The evidence of Gas Processing Management Inc. ("GPMI"), filed on behalf of the Canadian Propane Association ("CPA") estimates the direct economic value of the retail propane business in Ontario at $532 million, with a total economic impact (after considering the influence of multipliers on different sectors of the industry) of $1.285 billion.[64] Other "social cost" estimates that would be put at risk by uneconomic natural gas expansion include 2,990 people employed directly or indirectly in Ontario's propane industry, and foregone estimated employment growth of 2,000 to 2,160 in the propane industry.[65]

73. The displacement of existing fuel sources via the introduction of a subsidized competitor into an unregulated market has significant social costs that need to be considered alongside any benefits.[66] Enbridge and Union's proposals ignore these costs.[67]

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[64] Evidence of GPMI, Exhibit 9, Tab 9, p.13.

[65] Evidence of GPMI, Exhibit 9, Tab 9, p.14. GPMI estimated that if the economic criteria suggested by Union in EB-2015-0179 are approved, 80% of the propane business in Ontario is in areas where gas utilities could consider expanding. If such expansions are undertaken, 25% of the economic value associated with the propane business in Ontario would be lost ($133 million of direct economic value and $321 million of total direct and indirect economic value). GPMI estimates that 40% of the jobs in petroleum product merchant services (164), 20% of jobs in service stations/distribution facilities (75), and 20% of jobs in petroleum product manufacturing (37) for a total of 276 jobs would be lost.

[66] Exhibit S.12.Parkland.FRPO.1.

[67] Indeed, the main document filed by the utilities in respect of these other benefits is the ICF Report prepared for the Canadian Gas Association, filed as an attachment to a Union IR to CCC in EB-2015-0179 (Exhibit B.CCC.5), which discusses only benefits and has no discussion of costs. See also Transcript, Vol. 6, p.114, line 20 to p. 115, line 8.

Issue 5: Should the OEB allow natural gas distributors to establish surcharges from customers of new communities to improve the feasibility of potential community expansion projects? If so, what approaches are appropriate and over what period of time?

74. Parkland submits that charging new customers surcharges for community expansion projects is appropriate – it is respectful of the cost causation principle, economically efficient, does not distort competition with existing fuel suppliers, and is consistent with the Board's statutory objective of rational expansion.

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

75. Parkland is of the view that there are no other ratemaking or rate recovery approaches that would be appropriate. If the ultimate goal or justification for gas expansion is economic development in rural communities, then the most appropriate and least distortionary way to fund this would be via province-wide taxes not via a tax only on gas ratepayers.[68]

Issue 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?

76. Parkland's position is that new expansions ought to be funded by the beneficiaries of those expansions (new customers) with or without the help of the new host municipality (or other level of government). As such, an expansion plan's revenue requirement can sought to be recovered outside of any existing OEB-approved IR plan.

Issue 9: What types of processes could be implemented to facilitate the introduction of new entrants to provide service to communities that do not have access to natural gas. What are the merits of these processes and what are the existing barriers to implementation? (e.g., Issuance of Request for Proposals to enter into franchise agreements)

77. Parkland submits that expansion of gas distribution into new communities should proceed: (a) within the existing legislative framework, where the Board has ultimate authority for the approval of franchise agreements and CPCNs; and (b) in a manner whereby new

[68] Exhibit S12.Parkland.BStaff.5.

entrants are on a level playing field with the incumbent distributors (i.e., where incumbents cannot leverage their existing customer base to keep new entrants from providing service).

78. Parkland submits that the only way to implement the above is via a competitive process administered by the OEB. There is precedent for this – namely, the OEB process to designate a developer for the proposed East-West Tie transmission line from Wawa to Thunder Bay.[69] That process resulted in a robust competition to enter Ontario's transmission market, which is dominated by the incumbent Hydro One Networks Inc. Ultimately, a new entrant was selected based on a set of criteria established by the Board.

79. The evaluation criteria that the Board established to evaluate proposals from interested proponents were created specifically for the East-West Tie project, and included technical capability, financial capacity, proposed schedule (for development and construction), costs for various phases, opportunity for aboriginal participation, public consultation, etc. In Parkland's view, many of these would make sense for gas expansion, but it would be up to the Board to create a set of evaluation criteria that takes into account the differences between building network transmission assets (like the East-West tie) and granting exclusive CPCN rights to distribute natural gas in areas currently served by other fuels.

80. Based on the evidence filed in this proceeding, Parkland believes that at a minimum, any natural gas expansion framework that included a competitive process[70] for the franchise and CPCN rights in expansion areas should include:

(a) an explicit prohibition on the use of subsidies from existing customers as a means of covering the capital costs of the expansion;

(b) evaluative criteria that require the proposals to establish the need for the expansion project, based on evidence that includes:

(i) the existing levels of competition among existing fuel suppliers in the region; and,

(ii) the existing level and cost of existing service being provided by existing fuel suppliers.

(c) evaluative criteria that give preference to:

(i) utilities willing to take some of the risks associated with the expansion project, such as a lower ROE for a period of time, or tying their ROE to risks associated with cost overruns, customer conversion rates, and customer retention rates;

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[69] EB-2012-0140; see Phase 2 Decision and Order, August 7, 2013.

[70] See discussion under Issue 9, below.

(ii) municipalities or other levels of government willing to contribute to the capital cost of the expansion project, or share in the risks noted above;

(iii) the utilities' proposals for rates for the newly served area (including any surcharges); and,

(iv) proposals with minimal costs and risks to existing fuel suppliers (i.e., loss of business, employment, etc.).

81. With respect to item (c)(i) in the paragraph immediately above, Dr. Yatchew, under cross-examination, agreed with the notion of the bidding utilities sharing in the expansion risks:

> If you want to ensure that the proponent, the expanding utility, is doing its utmost to (a), minimise capital cost and (b) maximize conversion rates, one way to do that is to ensure that they share some of the risks.[71]

Issue 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?

82. Please see discussion under Issue 11, below.

Issue 11: What is the impact of the Ontario Government's proposed cap and trade program on the estimated savings to switch from other alternative fuels to natural gas and the resulting impact on conversion rates?

83. The difference in GHG emissions between propane and natural gas are insignificant.[72]

84. The utilities suggested that natural gas has a material advantage over propane in terms of natural gas emissions, but that suggestion was based on burner tip emissions, and failed to include fugitive and upstream GHG emissions.[73] When fugitive and upstream GHG emissions are included (and they are explicitly included in the Ontario cap-and-trade regime), that advantage largely disappears. Indeed, Ontario's recently released *Climate Change Action Plan* acknowledges propane as a lower-carbon fuel, and promotes the role

[71] Transcript, Vol. 7, p.22, lines 23-26.

[72] Exhibit S12.Parkland.BStaff.1 and 2; Affidavit of Gary Highfield (Parkland), para.13.

[73] Transcript, Vol. 1, p.169, line 24 to p.170, line 15.

of lower-carbon fuels (in transporation and home heating) as part of the solution in terms of transitioning to a low-carbon future.[74]

85. In terms of implementation, Ontario's cap-and-trade regime will place the GHG emissions obligations for both propane and natural gas on the fuel suppliers. Given the insignificance of the difference in GHG emissions between propane and natural gas, the cost implications of cap-and-trade on fuel switching would be immaterial (i.e., immaterial impact on conversion rates).

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

86. With respect to any grants [or loans] to municipalities for natural gas expansion, they should be treated as contributions in aid of construction to cover any PI shortfall. This would be consistent with how the OEB has treated any utility assets not paid for by the utility.

Conclusion

87. In developing a regulatory framework for natural gas expansion, the OEB should reject the utilities' proposals to have existing customers subsidize expansion to unserved areas, for the following reasons:

(a) the cost savings evidence of Union and Enbridge clearly shows that no subsidization from existing customers is required;

(b) subsidization by existing customers would violate the fundamental rate-setting principle of cost causality, since existing customers would receive no benefits from the expansion projects proposed;

(c) the utilities' proposals place not only the majority of the costs of gas expansion projects on existing customers, but also all of the risks of the expansion projects – and based on recent expansion initiatives in eastern Canada, such risks are real;

(d) from a regulatory economics perspective, allowing incumbent utilities to roll-in the capital cost of uneconomic expansions is economically inefficient;

(e) the economic inefficiencies of the subsidy are distortive of competition between these incumbents on the one hand, and new entrants and other fuel suppliers on the

[74] *Ontario's Five-Year Climate Change Action Plan (2016-2020)*, p.20.

other hand (since the latter have to pay market-based prices for capital expansion); and,

(f) subsidized natural gas expansion into unserved areas will harm and jeopardize the alternative fuel supplier businesses that have invested millions of dollars in rural Ontario to date – these are real costs that the utilities' proposals ignore.

88. Before establishing any generic long-term framework for natural gas expansion, the Board should convene a separate proceeding with a broader scope to:

(a) consider evidence about alternative methods to finance the time gap between the short-term capital cost requirements of new gas facilities and the long-term expected cost savings – evidence that the utilities failed to provide in this proceeding; and,

(b) consider the broader question of how best to lower the energy costs in rural and remote communities, which appears to be the real interest of the municipal and First Nation participants in the hearing – without presupposing that natural gas is the preferred option, particularly given that in many areas a vibrant, competitive fuel market exists, without the stranded asset risk unique to natural gas expansions.

89. In the alternative, if the Board establishes a long-term framework in this proceeding, that framework should require the Board to convene a competitive process for the franchise and CPCN rights in expansion areas, which process should include:

(a) an explicit prohibition on the use of subsidies from existing customers as a means of covering the capital costs of the expansion;

(b) evaluative criteria that require the proposals to establish the need for the expansion project, based on evidence that includes:

(i) the existing levels of competition among existing fuel suppliers in the region; and,

(ii) the existing level and cost of existing service being provided by existing fuel suppliers.

(c) evaluative criteria that give preference to:

(i) utilities willing to take some of the risks associated with the expansion project, such as a lower ROE for a period of time, or tying their ROE to risks associated with cost overruns, customer conversion rates, and customer retention rates;

(ii) municipalities or other levels of government willing to contribute to the capital cost of the expansion project, or share in the risks noted above;

(iii) the utilities' proposals for rates for the newly served area (including any surcharges); and,

(iv) proposals with minimal costs and risks to existing fuel suppliers (i.e., loss of business, employment, etc.).

Respectfully submitted,

June 20, 2016
Toronto, Ontario

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cc: EB-2016-0004 Intervenors