ONTARIO ENERGY BOARD

Application under the Ontario Energy Board's own motion to consider potential alternative approaches to recover costs of expanding natural gas service to communities that are not currently served.

WRITTEN SUBMISSIONS OF

INDUSTRIAL GAS USERS ASSOCIATION (IGUA)

PART I: INTRODUCTION AND IGUA POSITION

1. IGUA supports rational expansion of the gas distribution system.

2. To be rational, gas distribution system expansion must be economic.

3. At a broad level, economic distribution system expansion is expansion the value of which exceeds its cost.

4. There is little value to existing gas customers arising from gas distribution system expansion. Accordingly, the salient value to consider in determining whether an expansion is economic is the value to new expansion customers. If the benefits to new expansion customers outweigh the expansion costs, then the expansion is economic.

5. Further, if the value to new expansion customers exceeds the expansion costs, then new expansion customers should, everything else being equal, be prepared to cover the costs of the expansion, and thereby hold existing ratepayers harmless from such costs. This is the premise of the OEB's E.B.O. 188 policy for evaluation and approval of distribution system expansion.

6. Where economic expansions are not proceeding, there is likely a market failure. The market failure identified in this proceeding is the transactional barrier resulting from the extended time frame over which new expansion customers realize benefits sufficient to cover the costs to expand to communities relatively distant from existing gas infrastructure. This extended time frame prevents expansion customers from being willing, or able, to pay up front for the benefits of expansion which it will take some time for them to realize.

7. It is a legitimate role for an economic regulator like the OEB to address market failures involving the energy infrastructure and services which they regulate.

8. For example, departure from postage stamp rates to allow for expansion surcharges for customers in expansion communities can address timing barriers for economic gas system expansion.

9. ***IGUA supports the application of regulatory flexibility and creativity to address transactional barriers to economic gas distribution system expansions, for the benefit of new expansion customers.***

10. ***Supporting gas distribution expansion through permanent subsidies from existing customers is <u>not</u> an appropriate regulatory tool.***

11. Where a gas distribution system expansion is economic (that is, savings to expansion customers exceed expansion costs), forcing existing customers to subsidize the expansion simply transfers wealth from existing customers to expansion customers.

12. An economic regulator has no legitimate role in determining or directing the transfer of wealth from one set of regulated service customers to another. To the extent socially desirable, to facilitate economic development in the community or otherwise subsidize energy services to particularly vulnerable communities, wealth transfers from one group of Ontarians to another is a role for government.

13. Where a gas distribution system expansion is <u>un</u>economic (that is, savings to expansion customers do not exceed expansion costs), forcing existing customers to subsidize the expansion is not only unfair to existing customers, it is wasteful from a societal perspective. In this event the lack of gas service is not the result of a market failure. Rather it is the result of there being less expensive ways to provide energy services to would be expansion customers. In this circumstance as well, equalization payments, if deemed socially desirable, are the purview of government, not of economic regulation.

PART II: STRUCTURE OF THIS SUBMISSION

14. In Part III of this submission further develops positions set out in the introductory section.

15. In Part IV of this submission provides IGUA's position on each of the issues identified by the Board in respect of which IGUA takes a position.

PART III: ELABORATION OF IGUA POSITIONS

Little Value to Existing Customers from Gas Distribution System Expansion

16. The evidence advanced in this proceeding shows that gas distribution expansions provide little value to existing gas customers.

17. No party is advancing the proposition that existing gas distribution customers will see significant reductions in their costs of gas distribution service on account of gas system expansion.

18. The only evidence of monetary benefit to existing gas distribution customers is a reference by Union Gas in an interrogatory response[1] to a potential savings of 50¢ a year to Union's residential customers only, as a result of expansion customers absorbing some fixed costs of gas distribution services.

19. Union has also advanced some suggestion that historical expansion portfolio profitability indices (PIs) of greater than one have somehow resulted in subsidy of existing customers by expansion customers.[2] The proposition seems to be that such subsidies justify contribution by existing customers to distribution system expansions to serve new customers.

20. There is no merit to such a proposition. PIs of greater than 1.0 indicate that, at then current rates, revenues from expansion customers would more than cover expansion costs over time, with the result that existing customers would not cross-subsidize customers of such expansion. This is a mathematical check to preclude such cross-subsidy.

21. Rates do not, however, remain static post-expansion. Rates are reset such that all customers share on an equal basis in fixed costs of providing gas distribution services. Expansion customers see the benefit of such fixed cost "dilution" as do existing customers. As rates are reset for everyone relative to the rates used to calculate the expansion PI, there are in fact no excess future revenues. No pool of funds is generated from expansion projects to defray the costs of gas distribution service to existing customers. When rates are reset all customers share in the costs incurred to serve them, on an equal basis.

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[1] Exhibit S15.Union.BOMA.59; Exhibit J4.6.
[2] Exhibit A, Tab 1, page 7, lines 18-19; Exhibit S15.Union.IGUA.1

22. While there has been much made of “spin off” economic benefits expected from gas distribution expansion, there is no evidence quantifying such potential benefits. Rather their potential has largely been directionally assumed.[3]

23. Nor have any of those suggesting “spin off” economic benefits considered “spin off” losses, such as those resulting from displacement of existing fuel suppliers by expanded natural gas service.

24. In any event, to the extent that there are economic or other benefits to the province at large, the beneficiaries benefit not *qua* gas ratepayers, but rather *qua* Ontario citizens. Indeed, gas ratepayers and those without gas service would benefit equally, should such benefits in fact be realized. Should this be the expectation, then the appropriate funding mechanism would be through government programs, which are funded by all Ontario citizens through taxes, rather than by gas ratepayers alone.[4]

25. London Economics, whose evidence was sponsored by Union, indicated that the only reason they considered funding such broad based expected benefits through utility ratepayers was “administrative simplicity”.[5] This is an odd position to take given the already announced government gas expansion funding program.

26. Employment benefits, GDP benefits and the like, to the extent demonstrable, may be benefits that warrant government financial support for gas system expansion, in the interests of Ontario economic welfare at large. Such economic development policy is not the purview of an economic regulator, nor should it be funded from the subset of Ontario’s consumers who currently receive gas distribution services.

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[3] See, for example, the evidence on point from London Economics International: Transcript Volume 3, page 60, lines 1 through 20; Exhibit S15.Union. IGUA.7 and IGUA.8; Transcript Volume 3, page 49, lines 3 through 26.
[4] Transcript Volume 3, page 49, line 27 through page 50, line 8.
[5] Transcript Volume 3, page 49, line 27 through page 50, line 8.

27. Funding such broad economic benefits through gas delivery rates would distort price signals and the economics of gas consumption.

28. When "spin off" benefits have been spoken of by representatives of particular communities, the emphasis has been on the benefits to their own communities, which expected benefits have been advanced again and again as justification for expansion.

29. To the extent that such benefits are expected, the appropriate funding mechanism would be community funding mechanisms such as those proposed by Union and EGD; expansion customer surcharges and municipal contributions.

30. Any environmental benefits resulting from expanding the availability of natural gas and thus displacing more carbon intensive fuels currently in use in the subject communities are now fully recognized in the carbon pricing that will result from the government's carefully crafted cap and trade program. These benefits would already be internalized in the energy savings that would be realized by new expansion customers switching from more carbon intensive fuels to natural gas. While it is true that carbon reduction benefits will, in the end, accrue to all Ontarians (indeed, to everyone in the world), the monetization of those benefits is already included in savings which would be realized by expansion customers. If expansion customers realize the monetized savings, they should cover the associated costs.

31. There is no significant value to existing gas distribution customers from system expansion that would warrant forcing existing customers to cross-subsidize such expansion.

Social (non-monetary) Benefits of Extending Gas Services the Purview of Government

32. Everyone who was in the hearing room or listening in on the evidence provided by Anwaatin's witnesses and the mayors who appeared in support of Southern

Bruce's intervention will remember the sobering recounting of energy poverty in many First Nations and other rural communities in Ontario. No one in Canada should have to choose between heating or eating. No one should send their children to bed cold so that they can afford to drive them to school the next morning. These are very serious social issues which need to be addressed.

33. They are not, however, this Board's to address through economic regulation of Ontario's gas distribution system.

34. Social policy – including the redistribution of wealth to achieve basic social equity – is the purview of government.[6] The government has not empowered this Board to assume responsibility in this area, and this Board should not take it upon itself to do so.[7]

35. Were it to do so, it would be exceeding its jurisdiction. While the courts have found that "just and reasonable rates" can include consideration of ability to pay, such findings were made in the context of energy poverty within communities already served by natural gas.[8] Extending gas services to entire energy poor communities cannot reasonably be argued to have been under the court's consideration in making such determinations.

36. Equalization of energy costs across the province would be a very significant social welfare program, entirely different from the circumstances in the *Advocacy Centre for Tenants-Ontario v. Ontario (Energy Board)*[9] case, and is properly the role of government.

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[6] *Advocacy Centre for Tenants-Ontario v. Ontario (Energy Board),* [2008] O.J. No. 1970 (Div. Ct.), at para. 47 [*Advocacy*]
[7] *Advocacy*, at para. 49.
[8] *Advocacy,* at paras. 53-55.
[9] *Advocacy.*

37. The existence of a number of government programs – federal and provincial – seeking in some measure to address these issues is evidence of whose bailiwick such initiatives fall within.

38. Is more required to address these issues? That is a matter for government to grapple with. This Board has neither the legal nor, with great respect, the moral authority to do so. The members of this Board have not been elected. They are not directly accountable to Ontario's voters. The constitution and funding of such social policy and associated programs are the purview of our democratic system of government, not our economic regulatory system.

39. Apart from the evidence advanced in this proceeding regarding unacceptable fuel poverty in the remotest, or poorest, of communities, there has been a more general complaint advanced about the higher cost of fuel for residents and businesses more distant from the existing natural gas system. The premise of the representatives of these communities who provided comment or evidence in this proceeding appears to be that the Board should assume the function of equalizing energy costs across the province.[10] That is, that the Board should engage in the redistribution of wealth among Ontario's communities.

40. Programs to redistribute wealth and provide general economic support are a function of government, not this Board.

41. Attempting to address broad social policy through gas distribution rates would distort delivered gas prices. Not only would the Board be overstepping its mandate, and likely exceeding its jurisdiction, it would also be failing to fulfill its primary function of setting appropriately cost reflective utility rates.

[10] Transcript Volume 3, page 204, line 9, *et seq.*

42. A.J. Goulding from London Economics unreservedly agreed with the proposition that *"cost causation and ...avoidance of cross-subsidies is one of the most fundamental principles of utility rate design"*.[11]

43. Through the following exchange, Mr. Goulding went on to offer what he believes to be an appropriate hierarchy of principles to guide economic regulation [emphasis added]:

> *MR. MONDROW: Mr. Goulding, do you have a view that you could summarize for us on the role of an economic regulatory with respect to the making and implementation of social policy in a minute or less?*
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> *MR. GOULDING: So I appreciate the question. And I think that it's a challenging position to put an economic regulatory in. An economic regulator is not a policy-maker, but the devil is often in the details, and so the economic regulatory doesn't act in a vacuum. And, as such, to the extent that the framework that the regulator puts in place, even if it is focused solely on pure economic principles, if that is at odds with overall public policy, it's going to be very challenging for the regulator to achieve long-term stability in the jurisdiction. So you will set up a dynamic in which the economic regulator is at odds with policy-makers. So while I believe that the economic regulator must be guided primarily by strong economic principles, It's [sic] very difficult for that regulator to operate in complete isolation from policy.*
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> *So I think the question becomes: Is the economic regulator a policy-maker, from a broad umbrella perspective? I would argue no. But does it need to take policy into account when it's making its decisions as to what is economic? I think it does.*

44. IGUA endorses Mr. Goulding's hierarchy of economic regulation principles. IGUA's position is that it is appropriate for this Board to explore ways, within the confines of sound rate making, to facilitate gas expansion. Expansion surcharges, and potentially utility financing programs (property structure), would be appropriate accommodations of government policy favouring "rational" gas system expansion. Abandoning cost causation, avoidance of cross-subsidies, and other sound

[11] Transcript Volume 3, page 36, lines 13 through 17.

economic rate making principles to actively pursue government policy would not be.

Ontario Government Policy re Natural Gas Expansion

45. If it is to be guided in its economic considerations by government policy on facilitating natural gas system expansion, it is important for the Board to carefully consider the scope of that policy.

46. Such consideration indicates that the government has declined to adopt a policy for subsidizing gas system expansion through funds raised from existing gas customers, despite being so requested.

47. On February 18, 2015 the OEB issued a letter addressed to *All Applicants and Potential Applicants for Expansion of Natural Gas Distribution*. The letter commences by stating:

> *The Provincial Government has set out a goal of ensuring that Ontario consumers in communities that currently do not have access to natural gas are able to share in affordable supplies of natural gas.*

48. This characterization by the Board of the government's policy in this area has likely been the genesis of a number of assertions by parties to this proceeding that the Board's policy is to ensure access by rural and remote communities to natural gas.

49. Dozens of communities beyond those on the project lists advanced by Union and EGD have come forward for inclusion in the any subsidy program, and hundreds more would not doubt come forward should such subsidies materialize.

50. With all due respect, the Board's letter may have had the effect of overstating the government's policy.

51. The Board's letter followed immediately on a letter (dated February 17, 2015) from the (then) Minister of Energy to the OEB Chair.[12] The Minister's letter recites that as part of Ontario's Long Term Energy Plan (LTEP):

> *...the government committed to work with gas distributors and municipalities to pursue options to expand natural gas infrastructure to service more communities in rural and northern Ontario.* [Emphasis added]

52. The Minister's letter goes on to outline his request of the Board:

> *In my letter to you on June 26, 2014, with respect to the OEB's 2014-2017 Business Plan, I asked that the Board examine its oversight of the natural gas sector and to [sic] assess what options may exist to facilitate connecting more communities to natural gas.*
>
> *I am writing to you today to encourage the Board to continue to move forward on a timely basis on its plans to examine opportunities to facilitate access to natural gas services to more communities, and to reiterate the government's commitment to that objective. I appreciate your continued support to ensure the rational expansion of the natural gas transmission and distribution system for all Ontarians.* [Emphasis added.]

53. While requesting the Board to move forward with what has become this generic inquiry, the Minister did not formally direct the Board to do anything, despite the statutory authority to do so. He merely requested that the Board consider *"what options may exist to facilitate connecting more communities to natural gas"* [emphasis added].

54. With respect, this direct statement of government policy is a far cry from a policy of ensuring natural gas supply to all Ontario communities, as the Board's February 18, 2016 letter has been read to suggest.

55. Considered in further context of its genesis, this statement of government policy is instructive for what else it does not say.

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[12] Union's revised pre-filed evidence, Adobe page 53.

56. In the first Ontario Long Term Energy Plan (LTEP) in 2010, there was limited mention of the role of natural gas in Ontario's energy future.

57. Following the 2010 LTEP, the Ontario gas distributors began a public campaign to emphasize the importance of natural gas in Ontario's energy planning.[13] That campaign included, in particular, a suggestion that the government direct the OEB *"to allow for some greater level of cross-subsidization of expanding the network from existing utility gas customers to new customers in rural regions"*. At that time, Union was publically proposing cross-subsidies from existing customers in the range of $3.50 per year (for a residential customer).[14]

58. While the 2013 LTEP did specifically endorse opportunities to facilitate expansion of the gas system to rural communities, it neither adopted Union's subsidization suggestion, nor did it lead to a direction to the OEB.[15]

59. Following release of the 2013 LTEP, Union and EGD continued to lobby the Ministry of Energy to institute a subsidy program for natural gas system expansion. Union and EGD met with Ministry officials in January of 2014 to more specifically outline a program for rural and northern Ontario gas system expansion.[16]

60. That program specifically included;

(a) government grants; and

(b) a proposal for *"Directives to the OEB to allow for"*:

(i) ratepayer cross-subsidization;

(ii) capital pass through of expansion investments prior to the end of an incentive regulation period; and

(iii) expansion area customer contributions in aid of construction through a volumetric rate rider.

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[13] Transcript Volume 4, pages 179, line 10, *et seq.*; CPA Evidence, Adobe page 77 *et seq.*
[14] Transcript Volume 4, page 184, line 1, *et seq.*; EB-2015-0179, Exhibit JT1.9, Attachment 1, page 19.
[15] Transcript Volume 4, page 185, line 7 to page 186, line 4.
[16] Transcript Volume 4, page 186 line 5, *et seq.*; EB-2015-0179, Exhibit Jt1.10, Attachment 1.

61. The government has proceeded with the *"direct funding"* mechanism recommended by the utilities, having announced a $30 million grant program and a $200 million loan program to facilitate rural gas system expansion.[17]

62. The government declined, however, to issue any directives to the Board.

63. The government further declined to adopt, in any of its policy statements or public correspondence, any mention of ratepayer cross-subsidies to facilitate gas system expansion to rural or northern communities.[18]

64. The first mention of potential ratepayer cross-subsidies to facilitate natural gas system expansion (other than by Union or EGD) was the suggestion of the issue set out in the Board's February 18, 2015 invitation for applications. In that letter, after reiterating that minimizing cross-subsidization of expansions remains an important goal[19], the Board states:

> *To the extent that the economics of a proposed [expansion] project may not be accommodated within the current regulatory construct, the Board invites proponents to identify, within their applications, any options to address such regulatory issues.*

The Board goes on to list the 3 options put forward by Union in its discussions with Ministry Staff in respect of potential regulatory actions, as referenced above; i) surcharges to expansion customers; ii) recovery of capital investment costs during an incentive regulation term; and iii) ratepayer cross-subsidies.

65. Government policy regarding natural gas system expansion provides for subsidies in the form of a low interest loan facility and an associated grant program. It may well be that further funds to subsidize gas system expansion will be dedicated from the cap and trade scheme proceeds pursuant to the recently released Ontario *Climate Change Action Plan* (*CCAP*).

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[17] Transcript Volume 4, page 189, line 6 to line 27.
[18] Transcript Volume 4, page 193, lines 17 to 21.
[19] OEB February 18, 2015 Letter to *All Applicants and Potential Applicants for Expansion of Natural Gas Distribution*, page 2, 3rd paragraph.

66. No part of the government's policy, or its communications with the Board, suggest in any way the government's expectation or suggestion that the Board consider implementing further cross-subsidies within its regulatory framework. Indeed, despite repeated requests from Union and EGD to so direct, the government has declined to direct, or even suggest consideration of, such measures.

67. The suggestion that the government may be waiting for the outcome of this proceeding before finalizing the details of own gas expansion subsidy[20] in no way implies a suggestion that the government expects that this Board will, or should, proceed to require that existing gas customers cross-subsidize expansion customers.

68. Indeed, the government's own grant programs would, if such were to be the case, be largely redundant, which implies, if anything, that the government is <u>not</u> expecting that cross-subsidies will be an element of any revisions to the Board's regulatory framework to facilitate natural gas system expansions. (On the other hand, awaiting resolution of any changes to the regulatory framework for gas distribution system expansions would inform development by the government of criteria for qualification for grants or loans; a reasonable approach.)

69. The request (not directive) of the government to this Board was to consider options to facilitate *"rational"* expansion of the gas distribution system. This request adopts the language in section 2 of the *Ontario Energy Board Act, 1998*, which sets out the Board's objectives in respect of natural gas. Those objectives include facilitation of <u>rational</u> expansion of the gas distribution system. They also include protecting the interests of consumers with respect to prices of gas service. Nothing in any communications to the Board from the government suggest in any way an intention to expand the Board's functions in respect of the regulation of natural gas beyond those directed by its current objectives.

[20] Transcript Volume 4, page 193, line 24 through page 195, line 24.

70. It is well within the purview of the Board to support government policy by adopting flexible, creative approaches to rate making to address any market failures standing in the way of economic natural gas system expansion.

71. The Board should not tread into the purview of democratically elected officials by fashioning its own broad wealth redistribution or community assistance policy. To do so would offend the most basic economic rate making principles. To do so without express authority from the legislature would be exceeding the Board's jurisdiction.

The Projects Advanced Are In Fact Economic

72. Union and EGD have been quick to propose subsidies for gas expansion from existing gas customers. They have been advancing such proposals since at least January, 2014.

73. It appears that neither Union nor EGD have further developed options – such as longer term municipal or expansion customer contributions, low-interest financing options for customer conversions, incorporation of current or potential future government grant or loan programs in support of natural gas expansion/higher carbon emitting fuels – before resorting to proposals for existing customer cross-subsidies.

74. While IGUA opposes cross-subsidies from existing customers both in principle and as a matter of jurisdiction, a further reason for the Board to reject the suggestion to cross-subsidize expansions by requiring contributions from existing customers is that the utilities have not demonstrated sufficient effort to determine ways to move forward with rural expansion initiatives without such subsidization. That is, no "need" has been demonstrated for subsidies to address the government's gas distribution expansion policies, even if such subsidies would be appropriate and legal.

75. Indeed, it is not even clear that the utilities would not proceed without the cross-subsidies from existing ratepayers.[21]

76. For example, consideration of EGD's listed community expansion projects as a group, for example, indicates that they are economic. That is, the savings forecast to accrue to the expansion customers significantly exceeds the forecast costs of the expansions.[22]

77. The problem is <u>not</u> that the proposed expansions, at least as a group, are uneconomic. Rather, the problem is that the economics of converting to natural gas, including covering the expansion costs, from the customer's perspective require some time to be realized. This is a timing problem, and to some extent a function of the limitations of the historical approach to recovering the costs of gas system expansion.[23]

Appropriate Regulatory Framework Modifications

78. The communities which have been the subject of this proceeding do not have access to natural gas because under the Board's existing guidelines and "postage stamp" ratemaking approach, the up front contribution that would be required of expansion customers would be significant, and likely unaffordable to most of the expansion customers.

79. As evidenced by the high level calculations of the value of the proposed expansions compared to their costs put forward by EGD, in many cases expansion customers can theoretically cover the costs of the expansion from the fuel savings that natural gas would afford, and still enjoy substantial monetary benefit as a result of the expansion. However, unless they can contribute to the expansion

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[21] Transcript Volume 1, page 228, lines 8 through 11.
[22] EGDI Evidence, page 33, Table 10; Transcript Volume 1, page 224, line 16, *et seq.*
[23] Transcript Volume 1, page 225, line 23 through page 226, line 24; Transcript Volume 4, page 158, lines 3 through 10.

costs gradually over time, as they realize the energy savings, funding such customer contributions would be prohibitive for most customers.

80. The proposal by Union and EGD to allow expansion customers to contribute to expansion costs over time, through an ongoing surcharge, is a good example of an appropriate tool to provide regulatory flexibility to facilitate rational natural gas system expansion. IGUA endorses this proposal.

81. In respect of EGD's proposal to allow pass through the capital investment costs associated with community expansion projects during an existing incentive rate plan period, for inclusion in utility revenue requirement, IGUA supports this proposal as another good example of an appropriate tool to provide regulatory flexibility to facilitate rational natural gas system expansion. This would ensure that earnings sharing calculations during EGD's current rate plan period do not result in the utility foregoing its share of earnings as a result investing sooner rather than later in response to a government policy in favour of rational expansion.

82. In respect of Union this proposal is more complicated. IGUA is reticent to endorse the modification of a material aspect of an IRM plan the approval of which was supported by a negotiated settlement, absent agreement of all of the parties to the settlement. However, approving EGD's proposal in this respect while denying Union's would effectively penalize Union (in this respect at least) for having reached a settlement rather than litigating its current IRM plan. That result would be inappropriate. Accordingly, in these particular circumstances, IGUA is prepared to endorse affording Union the same regulatory flexibility, in support of the government's stated policy favouring rational gas system expansion, as it has endorsed for EGD.

83. Union and EGD have further proposed that the municipalities who will benefit economically from expanding natural gas services (both in respect of their own energy costs and in respect of the attractiveness and competitiveness of living or locating businesses within their municipalities and thus expanding their tax base) contribute towards the costs of the subject expansions. This is another good

example of a creative approach to solving the "timing" barrier to otherwise economic gas system expansions. To the extent that such mechanisms would be facilitated by acceptance of modifications to the Board's standard municipal franchise agreement, IGUA endorses acceptance of this innovation by the Board as another appropriate tool to provide regulatory flexibility to facilitate rational natural gas system expansion.

84. IGUA does <u>not</u> endorse relaxing the E.B.O. 188 guidelines designed to protect existing natural gas customers from subsidizing gas distribution system expansions.

85. If there is insufficient value resulting from a proposed gas system expansion to support customer and municipal contributions sufficient to allow expansion proposed projects to pass the E.B.O. 188 financial thresholds, then the subject projects are truly uneconomic and should not proceed. Existing ratepayers should not be required to subsidize natural gas expansion projects that are truly uneconomic.

PART IV: IGUA'S POSITION ON THE ISSUES IDENTIFIED BY THE BOARD

86. In concluding this submission, we provide IGUA's response to each of the issues identified by the Board in respect of which IGUA takes a position.

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?*

87. A definitive and fully referenced response to this question regarding the scope of the Board's ratemaking jurisdiction would require relatively extensive legal research. We expect that Union and EGD will have undertaken this research and will be addressing this question, and have elected not to duplicate this effort.

88. As outlined in Part III of this submission, IGUA endorses the opinion of A.J. Goulding of London Economics that cost causation and avoidance of cross-subsidization is at the foundation of economic regulation. We believe that the scope of the Board's ratemaking authority is legally tethered to recovery of the costs incurred in the provision of distribution services to the customers whose rates are being established. Without further legislative authority, we doubt that the Board has the jurisdiction to collect funds from one utility's customers to fund expansions by another utility.

Issue 3: *Based on the premise that the OEB has the legal authority described in issue 2, what are the merits of this approach?*

89. Even if the Board found that it had jurisdiction to collect funds from one utility's customers to fund expansions by another utility, for the reasons reviewed in Part III of this submission, the Board should decline to pursue such a course.

90. IGUA's position is that expansions that are not economic on their own terms should not be subsidized through gas delivery rates. Pursuit of such expansions are a matter of social policy, and the formulation and execution of social policy is the purview of government, not of the Board.

91. Evidence has been advanced in this proceeding regarding "universal service funds" in the telecommunications sector. That evidence is of limited assistance to the Board in this matter, for two reasons.

92. First, access to gas should not be considered an "essential service". While access to energy service might be considered essential in particular in climates such as ours, such energy service need not necessarily be gas service. The communities being considered in this proceeding already have access to energy service.[24] The

[24] We acknowledge the Anwaatin evidence regarding the substandard nature of energy services on some remote First Nations communities. IGUA does believe these are social issues that required attention. They are not, however, gas issues, rather they are energy issues. This Board does not regulate all energy. It regulates (aspects) of electricity and natural gas services.

issues raised in this proceeding relate to the relative economics of, and not the essential availability of, energy services.

93. Second, and we suggest arising from the first point, the telecommunications legislation includes specific objectives in support of universal telecommunications service. In contrast, the Board's legislative objectives in respect of gas system expansion are expressly qualified by the concept of "rationality".

Issue 4.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?

94. No change is required to the economic guidelines which the Board applies to gas distribution expansion proposals. These guidelines ensure that expansions undertaken are economic in their own right, and ensure that existing customers do not subsidize them.

95. Relaxing these guidelines would allow encumbent distributors to cross-subsidize expansions of their own system s from their existing customer base. New entrant distributors would not have that ability. Relaxing the current guidelines to preclude cross-subsidies would have the added detriment of raising barriers to entry for new natural gas distributors, as well as potential providers of other forms of energy services.

96. Confirming current economic guidelines, on the other hand, would ensure that the potential expansion customers see and consider the true costs of expansion of natural gas service to them. This cost transparency will send appropriate price signals in respect of alternative gas distribution providers and, more broadly, alternative forms of existing and emerging energy services.

97. Combined with the development of expansion customer surcharges to cover the costs of expansion of gas service, retaining current economic guidelines for natural gas expansions would facilitate appropriate market signals for extant and emerging energy services. Preserving price transparency and facilitating the economic

functioning of energy markets is a central objective of economic regulation, and the appropriate course for this Board to take.

Issue 4.f: *Should the economic, environmental and public interest components in not expanding natural gas service to a specific community be considered? If so, how?*

98. The questions posed in issue 4.f suggest considerations of economic and social policy in evaluating gas distribution system expansions. Considerations of economic and social policy should not drive the OEB's determinations on gas system expansions. These are matters for consideration and, as deemed appropriate, action by the government.

99. We note that environmental considerations in respect of carbon emissions will now be embedded in the relative costs of different fuel sources in Ontario. The Board's current economic criteria will thus include such considerations in that customer savings, and willingness to contribute to gas system expansions, will be influenced by the relative carbon emission levels of potential gas service compared to the fuel which gas would displace. This is an appropriate result.

100. Another consideration that might be appropriate in evaluation of future natural gas expansion proposals is the cost effectiveness of alternative energy options for potential expansion communities. In addition to the potential cost effectiveness of alternative forms of energy services, concerns regarding the long-term viability of gas delivery infrastructure merit consideration in respect of proposals to include 40 year gas distribution investments. The apparently increasing risks of stranded assets, and the potential impact of such stranding on future captive gas customers, should be considered in evaluating the potential benefits and risks of further expansions of the natural gas system.

Issue 5: *Should the OEB allow natural gas distributors to establish surcharges for 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?*

101. Yes, as outlined in Part III of this submission.

102. The scale and time frame for surcharges for any particular expansion project would be driven by the requirement to bring the expansion proposal into line with the Board's E.B.O. 188 guidelines for economic expansions.

103. The availability of other tools, either to assist customer's in realizing the savings from fuel switching (such as low cost conversion financing, government grants or loans) or to contribute towards the costs of the expansion facilities (such as municipality contributions or participation in expansion projects by large customers in the area) would properly be considered in determining a manageable quantum and/or time frame for expansion customer surcharges required to meet a project PI of 0.8 and a portfolio PI of 1.0 pursuant to the E.B.O. 188 guidelines for economic system expansion.

104. The application of surcharges to facilitate contribution by expansion customers to the costs of providing them with gas services has the added benefit of levelling the playing field between incumbent and new entrant distributors and providers of alternative energy options.

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?

105. Yes, for the reasons discussed in Part III of these submissions.

106. In respect of EGD's proposal to allow pass through the capital investment costs associated with community expansion projects during an existing incentive rate plan period, for inclusion in utility revenue requirement, IGUA supports this proposal as another good example of an appropriate tool to provide regulatory flexibility to facilitate rational natural gas system expansion. This would ensure that earnings sharing calculations during EGD's current rate plan period do not result

in the utility foregoing its share of earnings as a result investing sooner rather than later in response to a government policy in favour of rational expansion.

107. In respect of Union this proposal is more complicated. IGUA is reticent to endorse the appropriateness of modification of a material aspect of an IRM plan the approval of which was supported by a negotiated settlement, absent agreement of all of the parties to the settlement. However, approving EGD's proposal in this respect while denying Union's would effectively penalize Union (in this respect at least) for having reached a settlement rather than litigating its current IRM plan. That result would be inappropriate. Accordingly, in these particular circumstances, IGUA is prepared to endorse affording Union the same regulatory flexibility, in support of the government's stated policy favouring rational gas system expansion, as it has endorsed for EGD.

Issue 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?)*

108. IGUA supports competition where possible in the provision of energy services.

109. To the extent that other parties centrally concerned with this issue identify real barriers to competition for distribution franchises in the franchise agreement or certification forms or processes, the Board should consider measures to address such barriers.

110. We do not believe that the Board needs to assume an active role in otherwise competitive procurement processes for gas distribution franchises. Where completion functions properly, the Board need not, and should not, engage.

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.)*

111. Same response as to issue 8.

Issue 10: *How will the 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?*

112. The government's now detailed cap and trade framework will impact the relative value to expansion customers of gas service as compared to their existing fuels, and thus the ability and interest of expansion customers to contribute to the costs of expansions.

113. If the cap and trade framework increases the costs of potential expansion customers' current fuel sources relative to natural gas, more gas expansion projects should become economic. Conversely, if the cap and trade framework narrows the gap between alternative fuel sources and natural gas, some natural gas expansions may become less attractive to customers.

114. The point of carbon pricing is that the costs of greenhouse gas emissions are internalized in fuel and technology choices and become part of the customer's calculus in making such choices.

115. No regulatory intervention in this mechanism by the Board is required. The nature and extent of the economic signals for carbon pricing will be determined by government action, and will naturally influence both the economics of gas system expansion (as well as alternative energy choices), and the ability and willingness of customers to make contributions towards expansion costs required to meet the applicable economic guidelines for gas expansions.

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?*

116. See response to issue 10.

Issue 12: *How should the OEB incorporate the Ontario Government's recently announced loan and grant programs into the economic feasibility analysis? (How might the disbursement of these funds relate to the OEB's approval of expansion? What might be the optimal use of these funds?)*

117. If the government's announced loan and grant programs are designed to provide funds directly to potential expansion customers, they will facilitate equipment retrofit by customers, and increase the ability of customers to utilize savings resulting from fuel switching to contribute towards the costs of expansion of the gas distribution system to their communities.

118. In this instance, the impact of these programs will be on both the extent and the veracity of conversion forecasts, as well as on the reasonable quantum/duration balance of expansion customer surcharges.

Additional Issue: *What, if any, changes to the OEB's jurisdiction would be helpful in allowing the OEB to foster the rational expansion of natural gas service in Ontario?*

119. As outlined earlier in these submissions, to be rational, natural gas distribution system expansions must be economic. That is, benefits to expansion customers must exceed the costs of the subject expansion.

120. The breadth of the OEB's current rate making authority extends to the ability of the Board to approve expansion customer surcharges, to take into account and facilitate (through its standard form agreements) municipality contributions, and to allow pass through of community expansion investments during an incentive regulation period. No changes to the OEB's jurisdiction are required to enable appropriate facilitation of economic natural gas expansions.

ALL OF WHICH IS RESPECTFULLY SUBMITTED by:

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