ONTARIO ENERGY BOARD

EB-2016-0004

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

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REPLY OF THE CANADIAN PROPANE ASSOCIATION

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A. INTRODUCTION

1. The submissions of Union and Enbridge contain contradictions with respect to questions of jurisdiction, inaccurate and misleading figures and statements regarding comparative economics, false allegations about parties' motivations and questionable characterization of their own motivations, and incomplete assessments of the Board's options going forward.

   In response to the Board's invitation, Union and Enbridge have focused a substantial majority of their written evidence, oral testimony and final submissions on how their proposed projects can move forward, and in particular on what framework and what changes or exemptions to the EBO 188 framework are required in order to allow their proposed projects to move forward.

   We would submit that while responsive to the Board's questions, their submissions cleverly navigate around, without ever touching on, the substantive purpose and result of their proposals. They are not really about the virtues of EBO 188 or the merits of changes to or exemptions from the regulatory framework; those technical details are merely a distraction. At heart, their proposals are really about trying to maximize shareholder profits by:

   (a) expanding their customer base, their rate base, and the capital on which they earn a return, in order to maximize shareholder profits; and

   (b) generate new customer interest where there is currently none, by offering those targeted new customers something for nothing – a "freebie" – and forcing their unwilling captive other customers pick up the tab.

2. There is nothing wrong with LDCs seeking to increase profits. We would not expect otherwise. But we urge the Board to look through the regulatory diversions and the technical distractions and to recognize these proposals for what they really are. The LDC proposals are not about the public interest or government policy. If the government had announced a policy of having utility shareholders subsidize customers, for example, we doubt they would as eagerly bring forward proposals. The LDC proposals are about their own profits, returns and growth. We hope the Board will consider the proposals and the evidence with this in mind.

3. In the remainder of this CPA Reply, we intend to highlight some of the more significant contradictions, inaccuracies and diversions in an effort to assist the Board in seeing the underlying motivations at play.

B. JURISDICTION

4. Enbridge has submitted that:

> "*…the Board has been given no jurisdiction under the governing legislation to make allocative decisions about how funds recovered in rates from customers of a gas distributor might be used to … advance the interests of communities that are not served by the distributor.*"[1]

The CPA agrees fully with Enbridge's assertion. The Board has no jurisdiction to recover funds in rates of Enbridge and Union customers in order to use those funds to advance the interests of communities that are not served by Enbridge or Union. Yet Enbridge's proposal is to do exactly that. Enbridge has asked the Board to allocate funds collected in rates from its customers to advance the interests of Fenelon Falls, Scugog Island, Cambray, Zephyr, etc. – all communities which are not served by Enbridge. Enbridge's proposal is in direct contravention of its own assessment of the Board's jurisdiction.

5. In explaining why inter-utility subsidization is beyond the Board's jurisdiction, Union explains that the "doctrine of jurisdiction by necessary implication" does not apply in the present circumstances because there is no legislative objective at play, nor are there any expressly granted powers to impose a subsidy. The "just and reasonable rates" objective does not support an inter-utility subsidy, Union says. The legislature expressly granted powers to approve subsidies for electricity, but having turned its mind to the subsidy question, then decided against conferring that power on the Board in respect of natural gas.[2]

All of these assertions by Union apply equally to intra-company subsidies. There is no express statement in any statute, regulation or Directive that would provide any basis to differentiate between inter-utility and intra-company subsidies.

(a) As Union suggests, there is no legislative objective at play; in fact the objects are clearly set out in Section 2 of the OEB Act and refer expressly to rational expansion (not irrational) and to price protection for consumers (not non-consumers).

(b) If the "just and reasonable rates" objective does not support an inter-utility subsidy, there is no legal instrument that can be pointed to in order to suggest that intra-company subsidies are any different.

(c) As Union points out, the legislature expressly granted powers to approve subsidies for electricity, but having turned its mind to the subsidy question, then decided against conferring the power on the Board to approve subsidies in respect

[1] Enbridge Argument in Chief, Page 3 of 13, Paragraph 9.

[2] Submissions of Union, Pages 6-7, Paragraphs 16-18.

of natural gas. Union claims that when the legislature turned its mind to subsidies, it somehow impliedly decided to grant intra-company subsidy powers but deliberately denied inter-utility subsidy powers. That is incorrect. The legislature turned its mind to the idea of subsidies to support rural and remote communities that might not otherwise find grid connection and electricity consumption to be affordable, and quite clearly avoided any mention of <u>any kind</u> of subsidy for rural and remote gas users.

6. Union cites a 2015 Supreme Court of Canada case to explain the principle of just and reasonable rates. In the excerpt provided by Union, the SCC states:

> "*Consumers must pay what the Commission 'expects it to cost to efficiently provide the services they receive' such that 'overall, they are paying no more than what is necessary for the service they receive.'*"[3]

Existing customers are presumably paying today an amount that represents the cost to efficiently provide the services they receive and no more than what is necessary for the services they receive. If their rates were to increase, despite the services <u>they receive</u> being the same and the cost of the services <u>they receive</u> being the same, then the unavoidable conclusion is that they would be paying more than what is necessary for the services they receive – and therefore unjust and unreasonable rates. The Union and Enbridge proposals are to increase rates for existing customers without changing the services they receive, and not as a result of any cost increase in the services they receive. By Union's own explanation, these would be contrary to the Supreme Court's description of just and reasonable rates.

7. The only arguments made by either Union or Enbridge to differentiate between the jurisdiction to impose inter-utility subsidies and the jurisdiction to impose intra-company subsidies are as follows:

(a) *"…the proposal to amend/grant exemptions from the EBO 188 does not raise jurisdictional concerns…"*[4]

- Note that there is no explanation which follows this statement; just the bald statement on its own.

[3] *ATCO Gas and Pipelines Ltd. v. Alberta (Utilities Commission)*, 2015 SCC 45 at para 7., as cited in the Submissions of Union, Pages 8-9, Paragraph 21.

[4] Submissions of Union, Page 5, Paragraph 13.

(b) *"In contrast to the concept of cross-subsidization among utilities, there is no doubt that Enbridge's proposed community expansion framework is within the Board's jurisdiction."*[5]

- Again, there is no explanation which follows this statement; just the bald statement on its own.

(c) *"[Intra-company] cross-subsidization … is implicit where postage stamp rates are applied to multiple customers."*[6]

- This is the only substantive argument that was heard during the oral portion of the hearing, and it was heard repeatedly. Some level of subsidy is necessary in order have postage stamp rates, and postage stamp rates are necessary in order to avoid the administrative burden of having each customer pay a different rate depending on how many feet of pipe they use. CPA does not dispute this logic. The concept is that subsidy is to be avoided where possible, but is necessary to a small extent in order to reduce excessive administrative complexity. The postage stamp justification does not translate to the intra-company subsidies proposed by Enbridge and Union, however, because they are not necessary in order to reduce any administrative complexity, nor is that their purpose. Their purpose is to attract new customers and address customer affordability concerns. In fact, the subsidies proposed by Enbridge and Union (and EPCOR as well) actually add significant administrative complexity by creating a new subsidy charge, a new customer surcharge, a new incremental tax equivalent charge, new deferral accounts, and new portfolio classes. If the "administrative simplicity" justification for postage stamp rates is to be applied here at all, it would be to support the case against the proposed subsidies.

8. In any event, regardless of whether the charges imposed on customers to pay for the proposed subsidy are a fee or a tax, regardless of whether they are within or beyond the Board's jurisdiction, the Board should simply exercise its discretion to elect not to impose them. That should be the Board's decision because:

(a) The proposed subsidies are not just and reasonable.

- They contravene the legislative objectives, discard the principle of cost causation, interfere with robust competitive markets, and disassociate economic benefits from economic risks.

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[5] Enbridge Argument in Chief, Page 3 of 13, Paragraph 10.

[6] Submissions of Union, Page 12, Paragraph 29.

(b) The proposed subsidies are unnecessary.

- If the savings to new customers exceed the revenue requirement, then there is no need for a subsidy. Subsidies are only necessary when projects are uneconomic and yet are still desired – that is, where the savings and revenues are insufficient to fund the costs. Enbridge and Union insist that is not the case here, and that the savings are sufficient to fund the costs.

(c) The proposed subsidies are not balanced.

- They represent a transfer of wealth from existing ratepayers and from existing energy suppliers to new customers, LDCs and LDC shareholders.

C. ILLUSORY ECONOMICS

9. Union has misrepresented the true costs of providing natural gas service to rural communities, which has made gas falsely appear to be competitive with other energy sources. Union restates in its submissions that:

> "…*whereas the estimated annual cost of energy for a typical residential customer using natural gas would be $844, the equivalent cost would be $2,058 for a customer using propane… Even when conversion costs are accounted for, access to natural gas service can provide significant savings for energy customers*."[7]

While Union acknowledges that conversion costs will eat up some of the difference, conversion costs are not included in their final argument. If such costs were included, CPA submits that it would be clear that most or all of the "savings" would be eaten up by conversion costs.

However, far more troubling in the above cost comparison is the disregard and omission of the costs associated with laying the pipe to provide gas service. In fact, we know from the IRs that the cost for Union's projects is about $17,000 per customer, and the cost for Enbridge's projects is about $25,000 per customer. Before deciding how to allocate any savings (and therefore before deciding who should or should not pay a subsidy in order achieve such allocation), one must understand what the savings are that are to be allocated. Even if the costs are spread over a 10 year period, the per customer savings associated with Union's projects are negative: $844 + $1,700 = $2,544 to provide gas for a year, versus $2,058 to provide propane. Gas is $486 per year more expensive than propane when you consider all of the costs (propane costs already reflect the cost of capital equipment). Similarly, the per customer savings associated with Enbridge's projects are staggering: $844 + $2,500 = $3,344, versus $2,058 to provide propane. Gas is $1,286 per year more expensive than propane when you consider all of the costs. And

[7] Submissions of Union, Page 23, Paragraph 57.

that does not even reflect the customer's conversion costs, which Union estimates be another $2,000, or $200 per year over 10 years.

Union and Enbridge's formulas suggest that gas supply is cheaper than propane supply for rural communities. But that is only true if one omits the expansion costs from the equation.

Essentially, Union and Enbridge are asking the Board to order a subsidy of expansion costs in order to achieve savings for rural customers, but in fact those savings only accrue if you order a subsidy. This argument is circular. The conclusion (that a subsidy is merited) relies on the assumption (that there are huge savings) but the assumption in turn relies on the conclusion. As explained by the Consumers Council of Canada:

> "*Put more simply, if paying to have natural gas distributed to a house costs more than using electricity, it is because paying to have natural gas distributed to the house is more expensive than using electricity*."[8]

When you compare apples to apples and include, for gas service and for propane service, both the capital amortization costs and the operating costs, gas service is the most expensive way to provide energy to unserved rural and remote communities. That is beyond dispute based on Enbridge's and Union's own figures. Thus the justification for subsidies (cheaper energy) does not exist. The LDCs are not asking the Board to endorse their proposals so that remote customers can get cheaper energy. They are asking the Board to endorse their proposals so that remote customers can get the most expensive energy possible, but have someone else pay for it.

10. Union submits that:

> "…*the TES is designed so that customer contributions to project feasibility will be commensurate with the savings that the customer will realize by switching to natural gas*."[9]

This assertion is in direct conflict with Union's proposal that those customers will pay $506 per year in TES but will save $1,567 per year in fuel costs, leaving them with a net gain of $1,061 per year. A TES of $506 is not "commensurate with" fuels savings of $1,567. A TES of $1,567 would be "commensurate with" fuel savings of $1,567. That is the only TES that the Board should accept.

[8] Submissions of the Consumers Council of Canada, Page 15, Paragraph 53.

[9] Submissions of Union, Page 18, Paragraph 44.

D. PARTIES' MOTIVATIONS RELATED TO EBO 188 REVISIONS

11. Union states that:

> "*…little of the expansion of distribution services contemplated in this proceeding will be possible without some form of cross-subsidization .*"[10]

Enbridge similarly asserts that:

> "*In all cases none of these projects could go forward based solely on the current EBO 188 guidelines. No party to this proceeding has challenged this finding*." [11]

These statements are incorrect. A number of parties to the proceeding have indeed challenged these assertions by suggesting that these projects could go forward under EBO 188 by charging new customers a CIAC reflective of the actual connection costs (which, according to Enbridge and Union, would be less than the total savings to be realized by those same customers). The fact that most new customers would, given that option, consider their current energy supply to be a better value proposition, only means that many of the proposed projects would not go forward, due to a lack of customer interest. But that is not to say that they could not go forward or would not be possible under the current EBO 188 model. Nothing about the EBO 188 model prevents these projects from proceeding. It is the lack of customer interest – the customer's assessment that conversion is just not worthwhile – that would derail these projects, not any regulatory hurdle. Changing the regulatory framework in the manner proposed will not change the inherent value of fuel conversion (which unserved customers have determined to be negative); it will simply reallocate the losses from one group to another and reallocate the benefits, if any, in the opposite direction.

12. Enbridge describes its proposed framework as follows:

> "*Enbridge submits that any new feasibility model should 1) allow these projects to proceed,…*"[12]

The Board has indicated that it is trying to establish a framework for community expansion projects, against which it could test each proposed project to determine whether or not the project is feasible. Yet Enbridge proposes a framework under which projects are always deemed to be feasible. No matter the cost, no matter the economic impact, no matter the conversion rate, no matter the accuracy of their estimates, Enbridge seeks a feasibility test which results in a "pass" every time. And that is exactly what they have proposed: a model where (i) every project passes the PI test because there is no minimum PI (or it is set so low that every proposed project passes); and (ii) the tax on existing customers may be considered "reasonable" and "not undue" by the Board at

[10] Submissions of Union, Page 3, Paragraph 8(i).

[11] Enbridge Argument in Chief, Page 5 of 13, Paragraph 16.

[12] Enbridge Argument in Chief, Page 6 of 13, Paragraph 23.

$12.00/year, but Enbridge's forecast errors could cause that to double to $24.00/year after the project is built, when it is too late for the Board to reconsider the feasibility or reasonableness using the true figures. By Enbridge's own admission, the model they propose would render feasibility to be a truism; every project would pass the test. Such a framework should be rejected.

13. The CPA takes issue with Union's proposition that this proceeding is not about "*whether regulatory changes should be made, but rather how those changes are to be implemented*"[13] [Union's emphasis]. On the contrary, the Board has not already decided to radically alter or do away with EBO 188. EB-2014-0006 was intended to be that process.

    Union suggests that such regulatory decision has already been taken, in advance of EB-2016-0004 and even in advance of EB-2015-0179, and that such regulatory decision is set out in letters from the Minister and the OEB. However, the Minister has no power to make or impose such a regulatory decision, other than by way of Directive (and no such Directive exists). Similarly, a letter from the OEB inviting expressions of interest and inviting proposals for consideration at a hearing does not itself replace such hearing. The Board does not lose its mandate to decide issues simply because the Minister expresses support for one view. The Board's mandate is indeed to decide whether regulatory changes should be made, and in so doing to assess whether there are sufficient benefits to the concept of expansion to outweigh the burdens (i.e. whether it is in the public interest). Only if it decides this question in the affirmative should it go on to assess what those changes might be and whether they are within the jurisdiction of the Board to make.

14. Union's allegation that the status quo "is premised on the self-interest of competing fuel providers"[14] is interesting. The OEB came up with the status quo back in 1998, without any input from competing fuel providers. The CPA was not an intervenor in that proceeding. In fact, the status quo as originally adopted in EBO 188 was largely based on an ADR Agreement adopted by Union Gas and Consumers Gas (now Enbridge);[15] the status quo reflected Union and Enbridge's self interests more than any competing fuel provider's. Eighteen years later, Union and Enbridge – and once again not any competing suppliers – have come forward with proposals to change the status quo that they had originally endorsed, by seeking permission to:

    (a) expand their customer base at the expense of competing fuel suppliers and to the exclusion of competing distributors;

[13] Submissions of Union, Page 2, Paragraph 7.

[14] Submissions of Union, Page 4, Paragraph 10.

[15] EBO 188, Final Report of the Board, Appendix A.

(b) collect funds to pay for their capital expansion and conversion projects from existing customers, new customers, municipal governments, and provincial grants and loans – everyone but themselves and their investors;

(c) secure the maximum available return on equity with no allowance even for a marginally lower, but still profitable, return in order to alleviate the burden on their own customers;

(d) gain an anti-competitive advantage for their fuel trucking business by seeking a subsidy for LNG delivery trucks which compete side by side with propane delivery trucks competing to serve exactly the same customers;

(e) gain an anti-competitive advantage over potential new entrants by seeking a subsidy pool that only they can access in order to be able to undercut pricing from competing new entrants;

(f) force a regulator-endorsed increase in the rates of all of their captive customers, who will have no choice but to pay the increase and in return receive absolutely no tangible benefit or service, with the entirety of such rate increase being collected exclusively by and for the benefit of themselves; and

(g) transfer 100% of the risk for their own forecasting errors to customers, with Union and Enbridge and their shareholders sharing in absolutely no part of that risk, making this endeavour a 100% risk free business model for Union and Enbridge.

And yet they suggest that preserving the status quo would be giving in to the propane sector's self-interest.

We urge the OEB not to allow Union and Enbridge to conflate their own interests with the real public interest in this case – the adoption of a framework that:

(i) encourages projects where the measurable benefits outweigh the measurable costs;

(ii) disallows projects where the costs outweigh the benefits; and

(iii) properly aligns the bearing of those costs with the reaping of those benefits.

E. PATH FORWARD

15. Union and Enbridge both claim repeatedly and throughout their submissions that their model is the most balanced way to achieve the government's policy objective of enabling community expansion projects.

Firstly, the government's policy objective is not just to enable expansion, but to facilitate access to more communities through rational expansion:

> "*It is important to note that the Minister's letter did not indicate expansion at all costs but rather suggested a rational expansion of natural gas.*"[16]

Secondly, their proposals are anything but "balanced". Rather, they reflect the following imbalances:

(a) *Imbalance #1*: all proposed projects would be approved and none rejected;

(b) *Imbalance #2*: 100% of the risk would be transferred to customers and 0% of the risk retained by LDCs;

(c) *Imbalance #3*: imposition of a win-lose model in which one group of customers realizes all of the benefits while another group pays the costs and sees no benefits; and

(d) *Imbalance #4*: interference with a functional competitive market by unfairly subsidizing private sector methane delivery businesses to the detriment of competing unsubsidized private sector propane delivery businesses, thereby effective picking a winner and a loser among two private sector businesses competing for the same customers.

It simply is not true that there is no other more balanced way to facilitate rational expansion to more communities. A number of intervenors have put forward alternative methods of doing so, as has Board Staff.

16. The CPA is among those who have proposed a principled model for doing so, and its proposal can be found at Part VIII (pages 27-31) of the CPA Submissions. It would allow every person or entity who sees value in expansion or conversion (new customers, community groups, municipalities, provincial government, LDCs, etc.) the opportunity to contribute an amount equal to the value they see in the project, and then have the Board assess the feasibility taking into account all of those new revenue sources. If the combined values attributed by all parties (which may include values attributed to competition, GHG reductions, fuel cost savings, or anything else) exceed the costs (or even exceeds 80% of the costs under the EBO 188 model), then the project should

[16] OEB Staff Submission, Page 18.

proceed. But if the project is still not feasible – is not able to satisfy the EBO 188 PI thresholds of 0.8 and 1.0 – even when quantifying and factoring in all of the value that all parties attribute to the project, then the project should not proceed because that means that (i) nobody sees enough value in the project to justify the costs, and (ii) even in the aggregate, all parties combined do not see enough value in the project to justify the costs.

17. Other intervenors, including the Ontario Petroleum Institute, Northern Cross, LPMA, Ontario Geothermal Association, EPCOR, Consumers Council of Canada, Federation of Rental-housing Providers of Ontario and IGUA have proposed variations of the CPA model, in which projects must have a PI of 1.0 (or 0.8) and the Board can consider various sources of funding contributions as a CIAC when determining whether the project satisfies this threshold.

    Still others have suggested simply maintaining the status quo in its entirety, including Energy Probe and BOMA.

18. We urge the Board to seriously consider the CPA's proposed framework, and indeed the alternative models proposed by intervenors other than Union and Enbridge. Many of the intervenors' models provide a far more balanced and rational approach than the severely imbalanced models proposed by Union and Enbridge; they are models which are based upon a rational assessment of aggregate value and the broader public interest, and not based predominantly on a desire to increase LDC shareholder profits by irrationally increasing their customer base.

All of which is respectfully submitted.

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