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July 11, 2016

COURIER & EMAIL

Ms. Kirsten Walli, Board Secretary

Ontario Energy Board

2300 Yonge Street, 27th Floor

Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: EB-2016-0004 Submission of EPCOR Utilities Inc.

We are counsel to EPCOR Utilities Inc. in the above-referenced proceeding. Further to Procedural Order No.3 from the Board dated May 30, 2016, we enclose EPCOR's Reply Submission.

Yours truly,

Gordon Kaiser

Cc: Charles Keizer, Torys

Fred Cass, Aird Berlis

THE ONTARIO ENERGY BOARD

Generic Proceeding on
Natural Gas Expansion in Communities that are not served.

**REPLY ARGUMENT OF
EPCOR UTILITIES INC.**

July 11, 2016

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A. Introduction

EPCOR offers the following arguments in Reply. These need to be understood in conjunction with the earlier submissions made by EPCOR in its Argument, dated June 20, 2016.

Expansion of gas service to unserved areas is challenging given the high costs of connecting more distant and less densely populated communities. The support of the Ontario provincial government (Government) and the continued outlook for low natural gas prices provide an opportunity to achieve this goal. However, to achieve this goal, EPCOR believes that all parties must contribute, utilities need to bear their fair share of the risk, and a level playing field is required so that competitive forces produce innovative and flexible solutions.

B. Ratemaking Principles

The Community Expansion Deferral Account

Union is seeking accounting orders to establish a community expansion project deferral account. This account will be used to capture any variances between forecasted net revenue requirement approved in rates and the actual revenue requirement for all community expansion projects including timing differences between the in-service dates and inclusion rates. This new proposal in effect shifts the economic and financial risk from utilities to the customers, which effectively eliminates incentive regulation. As is discussed further below, any revenue shortfalls or cost overruns would be paid for by ratepayers. In EBO 188, the Ontario Energy Board (Board) established 'profitability index' (PI) thresholds in an attempt to limit the risk to customers. If Union is allowed to establish its deferral account the risk to the utility is eliminated and as a result, is shifted to the ratepayers.

At page 19 of Board Staff argument, Board Staff appears to accept the establishment of this deferral account. However, it is not immediately clear why as Board Staff argument states only that the deferral account would capture actual revenues and costs which would reduce the forecasting risk for both, ratepayers and the utility.

EPCOR agrees with the reasons set out by London Property Management Association (LPMA) in its argument as to why the deferral account should be rejected:

The first of these deferral accounts is the Community Expansion Project Deferral Account. This account would be used to capture any variance between the forecast net revenue requirement approved in rates and the actual revenue requirement for all community expansion projects, including timing differences between the in-service date and the inclusion in rates.

LPMA submits that this reduces Union's risk associated with the net revenue requirement to zero. Under cost of service regulation, Union is at risk for any

variance between forecast and actual net revenue requirement. This net revenue requirement reflects differences in the level of capital expenditures as compared to forecast, the timing of these expenditures, the customer attachment forecast (level and timing) and the average use per customer forecast. Union's proposal eliminates all of these risks and provides them a guaranteed return on the equity component of the capital added to rate base.

There is no incentive for Union to control its capital expenditures. If they go over forecast, they will earn more money. There is no incentive to forecast accurately in terms of either customer attachments or average use per customer. If customers do not attach in the levels forecast by Union or they consume less than that forecast, Union has complete protection.

There is a similar level of risk for a utility under an incentive regulation plan. Higher capital expenditures lead to a lower rate of return, as do lower than forecast customer attachments and/or use per customer.

Union proposes that any variance in the account be cleared to all customers. This means that Union has transferred 100% of the risk, including the weather risk, to customers. Union's shareholder has no risk whatsoever, unlike under either cost of service or IRM.¹

As EPCOR has indicated in its evidence and argument, the shifting of risk from utilities to ratepayers significantly reduces incentives for efficiency and is fundamentally inimical to the Board's incentive-based approach to regulation. For the reasons stated above, EPCOR opposes the establishment of this deferral account.

[Jurisdictional Issues Relating to the Advance Reinforcement Charge](#)

In this proceeding Union has asked the Board to approve a new charge to be paid by EPCOR as a condition of obtaining gas supply to serve three municipalities in South Bruce County. The charge which is outlined in Exhibit K7.1 is \$4.2 million.² If approved, it would effectively prevent these municipalities from obtaining gas supply.

EPCOR submits that the Board does not have the jurisdiction to approve the advance reinforcement charge that Union has applied for. Section 36 of the Ontario Energy Board Act states that the Board may make orders fixing and approving just and reasonable rates for the transmission, distribution and storage of gas and that in doing so the Board may adopt any method or technique it considers appropriate. However, the Ontario Divisional Court has made it clear that under the statutory provisions empowering the Board to adopt any "method or technique" in the fixing or approving just and reasonable rates, the traditional approach of cost of service continues to be the root

¹ London Property Management Submissions, June 20 2016, EB-2016-0004, Pages 9-10.

² Reproduced in Argument of EPCOR Utilities Inc. June 20, 2016, Appendix A.

principle.³ According to the Divisional Court the cost of service approach is necessary to meet the fundamental core objective of balancing the interest of all consumers and the natural monopoly in rate setting.⁴

In this application for a new advance reinforcement charge the costs are speculative. So much so that it is proposed that the rates contain a condition that the amount will be refunded to the customer if the costs do not materialize. The Board does not have the jurisdiction to set this type of rate. This rate is contrary to any cost of service principle as set out in the *Advocacy Center* decision referred to above.

Moreover, the Board does not have the evidence that is necessary to make any determination with respect to the proposed charge. Much is made of the *Port Elgin* decision⁵ 20 years ago when Union charged that municipality \$6 million for advance reinforcement notwithstanding the Board had no evidence before it.⁶ Despite the requests in this proceeding no evidence has been provided by Union as to whether there was any actual reinforcement and what cost was actually incurred. If the reinforcement did not take place was the money refunded? How can the Board approve a rate based on increased costs when in the one case where the rate was approved, the actual costs have never been determined?

There is another reason why the Board does not have the necessary jurisdiction to set this charge. Rates or charges which discriminate between customers or against competitors are not lawful.

Union and EPCOR compete for franchises and as the Board's objectives indicate, competition in the supply of natural gas is in the public interest. The prohibition against unjust discrimination in monopoly utility rates is a longstanding common law principle.⁷ Unjust discrimination usually refers to discrimination between customers. However, as the Federal Court noted in *Challenge*⁸ the unjust discrimination principle also prohibits a monopoly utility from discriminating against a competitor. EPCOR submits that the purpose and intent of the advance reinforcement charge in this case is not based on economics but is designed solely to prevent EPCOR from serving the three municipalities of Southern Bruce. EPCOR further submits that the enactment of

³ *Advocacy Centre for Tenants-Ontario et al v. Ontario Energy Board*, 2008 CanLII 23487, at paragraphs 52 and 58.

⁴ *Ibid.*

⁵ EBLO 259 (April 30 1997).

⁶ *Ibid*, page 14, para. 4.1.14.

⁷ *St. Lawrence Rendering Company LTD. v. City of Cornwall* (1951) OR 669 at 683; *Attorney General of Canada v. City of Toronto*, 1893 SCR 514.

⁸ *Challenge Communications Ltd. v. Bell Canada*, Telecom Decision CRTC 77-16 3 CRT 489 (23 December 1977) Aff'd [1979] 1 FC 857, 86 DLR (3d) 351 (C.A. 1978).

discriminatory rates is outside the Board's jurisdiction.

Further Considerations Relating to Advance Reinforcement Charges

In its argument, Union continues to assert that 'Advance Reinforcement Charges' are appropriate. In addition to the jurisdictional argument, EPCOR disagrees with the charge for four reasons. Such charges are discriminatory and arbitrary, they comprise a form of marginal cost pricing, they impede competition and are a barrier to entry, and they create perverse incentives.⁹

1. Advance reinforcement charges are discriminatory in that they give Union customers preferential treatment vis-à-vis customers of new entrants.¹⁰
 - a. Consider a circumstance where an unexpected surge in growth of Union customers results in the need for accelerated system reinforcement. Then consistent application of the idea would imply that these new Union customers should be required to pay for the incremental capital costs.
 - b. Similarly, consider a circumstance where there is an unexpected growth in demand volumes by existing customers. Then, those customers whose demand exceeded levels predicted by Union would need to pay for incremental system capital costs.

Clearly, in neither of these cases would such charges be applied, nor would it be simple to identify the customers or to reasonably predict their loads.

2. Advanced reinforcement charges are a species of 'marginal cost pricing' with respect to capital expenditures. The proposal would require EPCOR or other Union competitors to pay the incremental capital costs associated with the distribution system that is shared by many Union customers.¹¹ Marginal cost

⁹ Board Staff submissions appear to support a somewhat restricted version of the Advanced Reinforcement Charge. "OEB staff is in broad agreement with Union's proposal and agrees that if a specific project causes or brings forward additional reinforcement of an upstream pipeline system, the project should be responsible for the reinforcement costs. However, it is not clear if there is any remedial measure if the reinforcement does not occur within the three year window. It is possible that reinforcement is not required as the expected additional volumes do not materialize. Furthermore, considering the Ontario Government's implementation of a cap and trade program and initiatives to reduce Greenhouse Gas (GHG) emissions, natural gas flows may not increase as expected or even decrease to meet the GHG reduction targets of the Province. In such a case, there could be enough capacity such that no reinforcement is required. Accordingly, OEB staff submits that if an advancement charge is applied and the reinforcement does not materialize within the three year window, the amounts collected should be refunded to the party/parties that paid the advancement charge." OEB Staff Submission, June 20 2016, page 26.

¹⁰ In this connection, Union states that it "... does not want to be in a position where a small customer would be unable to connect because the system capacity has been fully exhausted" (Submissions of Union Gas, June 20, 2016, para. 79, page 30). It should be noted that the Southern Bruce communities are comprised of many such small customers which will indirectly be served by Union.

¹¹ This should not be confused with capital expenditures made exclusively for the benefit of the expansion, such as a pipeline connecting the Union system to a new community.

pricing is *not* a valid cost allocation principle for *common* costs. If it were, then to the extent that there is excess capacity on the system, a new community should be able to attach to the system for free. Once again it is important to reiterate that system reinforcement benefits all downstream customers, not just new customers attaching to Union's distribution network or to that of EPCOR.

3. Advance reinforcement charges impede competition and are a barrier to entry. In two decades, the charges have evidently been applied by Union on only one occasion (Enbridge does not impose such charges). Is it plausible to believe that capital expenditures have never required acceleration as a result of growth in Union customer base or sales during this period? A more plausible explanation for the invocation of the charge at this time is as a deterrent to entry by a competitor.
4. Advance reinforcement charges create perverse incentives. Analysis of system requirements depends not only on sophisticated engineering assessments but also on predictions of customer numbers (residential, commercial and industrial) and their demand volumes. The incumbent would be incentivized to skew plans and predictions in ways that would discourage entry. This in turn would increase regulatory and judicial burden as the review of such charges would require close scrutiny.

The Capital Pass Through

Union has asked the Board to approve an automatic capital pass through. This essentially means that Union (or any utility which builds facilities in an expansion market) can include the new capital in rate base as soon as it becomes used and useful.

One of the consequences of incentive ratemaking is that capital does not enter into rate base until rebasing. EPCOR believes that this is an unintended consequence which is particularly important in expansion markets. These markets are challenging in economic terms and therefore it is important that utilities can begin to earn returns on capital as soon as that capital is put to use.

Changes to EBO 188

Union and Enbridge propose significant reductions to the current minimum threshold PI set by EBO 188. Union has suggested a reduction to 0.4. Enbridge has not suggested any minimum for individual projects. OEB staff proposes that the individual project PI should move from 0.8 to 0.7. However the PI of 0.7 would be inclusive of the expansion surcharge and the ITE contribution.

EPCOR supports the views of the Industrial Gas Users Association (IGUA) where it opposes lowering PI levels as proposed by Enbridge and Union.¹² EPCOR contends that the real solution is not to allow more marginal projects, but rather to increase the

¹² Written Submissions of Industrial Gas Users Association (IGUA), June 20 2016, Pages 20-21.

funding available from the level that is currently available.

EPCOR does not believe a portfolio approach makes sense in expansion projects. Each project should be assessed on its own merits. The PI should be 1.0 after all contributions including government contributions are taken into account.

Bundled Rates

Rapid conversion rates are essential to the success of an expansion project. In many cases, households may be reluctant to proceed because of the large initial capital outlay required for conversion. In order to facilitate this process, utilities should have the flexibility to provide bundled rates which incorporate the costs of customer conversion. This would allow customers to distribute capital costs over time without the need for seeking bank financing.

Summary

1. Incentive regulation should apply in all expansion markets.
2. The expansion deferral account proposed by Union should be rejected.
3. The Board does not have jurisdiction to set 'advance' reinforcement charges.
4. 'Advance' reinforcement charges should be rejected. Reinforcement charges should be a common charge.
5. A capital pass through should be allowed.
6. The PI should be 1.0 after all contributions from the Government, current and future customers, municipalities and utilities are taken into account.
7. Utilities should be permitted to offer a bundled rate which includes in the cost of gas service the costs of equipment necessary to achieve the conversion.

C. Base Rates in Expansion Markets

In this proceeding, Union has also raised a question with respect to the establishment of base rates. In particular, Union argues that the competitive bidding process used by the Southern Bruce municipalities was flawed because EPCOR did not include rates in its proposal. As a result, Union is arguing that proposed rates must be reviewed by the Board in all franchise hearings.

EPCOR contends that the Southern Bruce competitive bidding process was not flawed as the single most important factor at the bidding stage is the amount of aid to construct required by the utility. EPCOR believes that is satisfactory information at that stage and that franchise hearings should not effectively become rate hearings.

Before any utility can offer service, rates must be approved by the Board. EPCOR's

position is that rates should be considered as part of the leave to construct application as at that point all the project costs will have been finalized.

On the other hand, Union contends that it can use its postage stamp rates as its base rate in expansion markets. EPCOR rejects this argument as there is no legal or economic basis for this position. Postage stamp rates were not developed to mask the magnitude of subsidies required in expansion markets.¹³ Postage stamp rates, as Board Staff points out, were designed to avoid administrative costs and involve minimal subsidies between markets. This is not the case in expansion markets. The base rate in an expansion market should be set on a stand-alone cost of service basis. This principle should apply to all utilities.

In other words, for expansion markets, all utilities must apply for the base rates at the time of the leave to construct and these rates should reflect the cost of serving that specific market. EPCOR believes it is important that the Board demonstrate its commitment to a level playing field as this process moves forward.

Summary

1. Base rates should be approved at the time of the leave to construct for *all* utilities.
2. Base rates should be based on the cost of serving that expansion market.
3. The use of postage stamp rates should be rejected for expansion markets, for all customer classes.

D. New Customer Surcharges

Contributions by the New Customers

With respect to new customer surcharges, Union and Enbridge disagree on the term. Enbridge says the maximum term should be 40 years and that surcharge should apply to *all* customers. Union would limit the maximum term to 10 years and would not apply the charge to industrial customers.

EPCOR agrees with Enbridge that the term should be 40 years and the charge should apply to all customers. While Board Staff supports a maximum term of 40 years, Board Staff agrees with Union that no charge is necessary for the industrial customers.¹⁴

EPCOR believes that the charge must apply to all customers on an equal volumetric

¹³ OEB Staff submission, June 20, 2016, EB-2016-0004, Page 12.

¹⁴ OEB Staff submission, June 20, 2016, EB-2016-0004, Page 15.

basis. EPCOR does not believe that it is financially possible to build the new systems if the new customer surcharge is limited to residential customers. While EPCOR agrees with Board Staff that it may be possible to develop a rational natural gas expansion program without contributions from existing customers such a program is only possible if all new customers contribute.

Nor does EPCOR accept Union's argument (which is based on scant evidence) that industrial customers will not pay the surcharge. EPCOR believes that *all new* customers must contribute their fair and justly allocated share of the overall system cost of service and surcharges in new markets, regardless of class.

EPCOR submits that the regulator must intervene and ensure that there is a level playing field. It is EPCOR's view that these projects will fail unless there is equal contribution from all classes of customers. Furthermore EPCOR believes that surcharges, like base rates, should not discriminate unjustly against other rate payer classes. Blanket exemptions are not lawful unless the Board finds them to be justified. The evidence for a blanket exception does not exist.

Union and Enbridge appear to agree on the surcharge rate namely \$.23 per cubic meter which translates to \$500 per year for a residential consumer. However, just as the term can and should be increased where necessary, EPCOR believes there must also be rate flexibility. A utility should have the option of applying for a higher surcharge than \$.23 per cubic meter where the economics of the market require it.

As Board Staff and other parties acknowledge the savings to new customers in expansion markets can be substantial. In EPCOR's view the Board should set the rate at 23 cents per m³ or such other rate that the parties have agreed to and the Board finds to be just and reasonable. In expansion markets one size will not fit all.

In addition, Union has claimed that the rate impact is lower if the proceeds are treated as revenue as opposed to an aid to construct. An elementary argument dismantles this claim: funds treated as an aid to construct reduce the capital cost of a project and therefore do not attract a rate of return; those treated as revenues do not yield a similar offset, thus increasing the present value of payments by ratepayers. It is EPCOR's position that these contributions, as well as contributions by existing customers and the Government should be treated as an aid to construct.¹⁵

Summary

1. The new customer surcharge term should be a maximum of 40 years.
2. The new customer surcharge rate should be 23 cents per m³ *or such higher rate* that the Board approves.
3. The new customer surcharge rate should be paid by all customers.

¹⁵ For a quantitative treatment of this argument, see Submissions of London Property Management, June 20 2016, EB-2016-0004, Pages 11-13.

E. Existing Customer Surcharges

A threshold issue in this generic proceeding turns on one question: does the Board possess the jurisdiction to enact plans proposed by utilities to cross-subsidize new customers with funds from existing customers? Union and Enbridge claim that the plan proposed by EPCOR is not within the Board's jurisdiction, whereas EPCOR claims that the plan proposed by Union and Enbridge is not within the Board's jurisdiction.

The jurisdictional question, in certain critical respects, turns on how the Board decides to categorize the proceeds from the existing customer surcharge. Union and Enbridge claim it is revenue. EPCOR contends that the surcharges should be seen as an aid to construct as the purpose of the existing customer surcharge is to underwrite the capital cost of expanding natural gas system in new markets not currently served and the surcharge is not being paid for any service provided by a utility.

In Union's submissions, Union states: "To charge one utility's customers an amount that would be used as a subsidy for another utility would be to include in the first utility's revenue requirement costs that are unrelated to the activities of that first utility".¹⁶ In its submissions, Enbridge states: "According to the Divisional Court, a cost of service approach is necessary to meet the fundamental, core objective of balancing the interests of all consumers and the natural monopoly in rate setting. The cost of service of a gas distributor does not include the costs of funding expansion of service by another distributor".¹⁷

The Enbridge and Union argument that the EPCOR proposal for a province-wide plan is outside of the Board's jurisdiction is fundamentally based on the assumption that the proceeds from the existing customer surcharge are revenue. When the proceeds from the existing customer surcharge are treated as an aid to construct, the arguments of Union and Enbridge are no longer applicable.

Unjust Discrimination

The EPCOR objection to the Union and Enbridge plan is that the resulting rates involve unjust discrimination. The Board has jurisdiction to consider matters of broad public policy in setting rates but setting rates to fund natural gas expansion which limits access to certain groups of citizens is poor public policy and poor utility law. As EPCOR contended in its submissions, rates that involve unjust discrimination simply are not legal.

Moreover, rates that involve unjust discrimination are also contrary to the Board's objectives as an important Board goal is to promote rational expansion of natural gas systems. A plan that only benefits certain Ontario residents and excludes others, is, in

¹⁶ Union Gas Submission, June 20, 2016, EB-2016-0004, Para. 23, Page 9.

¹⁷ Enbridge Gas Distribution Inc. Argument in Chief, June 20, 2016, EB-2016-0004, Para. 8, Page 3.

EPCOR's view, not a rational plan. Rather, EPCOR believes that a rational plan must benefit all citizens equally and any acceptable plan cannot limit the benefits to customers served by just two utilities.

EPCOR contends that the Union and Enbridge proposals also violate another fundamental Board objective, which is to promote competition in the provision of natural gas. This objective has been established by the Legislature which supports the position that greater competition promotes the public interest. We have seen evidence of these benefits from the process conducted by the three Southern Bruce municipalities.

Administrative Costs

Much of the Union argument against the EPCOR proposal is that it will increase administrative costs. However, EPCOR believes that administrative costs in a Board fund are likely to be similar to Union's, given that the Board will still need to oversee the use of the funds under Union and Enbridge's proposals, and may even be lower if the funds are placed with the Board in the first instance given that only one entity will administer the funds and not multiple utilities, as would be the case if each utility were to each administer their own funds.

More importantly, the analysis turns on the same fundamental question - are the proceeds from the existing customer surcharge an aid to construct or is it a revenue? If it is an aid to construct the administrative tasks and therefore costs are for all intents and purpose likely to be similar, regardless of whether the utility or the Board holds the funds in the first instance. Under the Union option each of the utilities would incur those costs, while under the EPCOR proposal it would streamline it to a single entity – the Board.

Under the aid to construct regime the Board must recognize that the funds raised from the customer surcharge are raised for a specific purpose. The Board has an obligation to advise those customers of the reason for the rate increase. The Board must also ensure that the funds are used for that specific purpose. Regardless of whether funds are held by the Board or by two utilities they can only be distributed by Order of the Board. That order would identify what utility receives payment, the municipal franchise to be served, and the amount of the payment.

Union appears to believe that the utility will administer the funds without any supervision from the Board. Union says this is desirable because it will result in lower administrative costs. Union comes to that conclusion because Union believes it can convince the Board that the funds should be treated as revenue and if so Union can do what it likes with the funds.

The key features of the administrative procedure are (1) there can be no disposition of funds without a Board Order setting out the amount, determining the recipient utility, and the benefiting municipality; and (2) a Board ruling in this decision that the utilities eligible for funding are all Ontario gas distributors that hold franchise agreements and CPCN

certificates in expansion markets. If the Board holds and disburses the funds, regulatory burden and administrative costs are likely diminished.

Rate Impacts

In its submissions, Board Staff has concluded that the Board likely does have jurisdiction to create some form of expansion fund that creates subsidies between utilities and ratepayers:

It is OEB staff's conclusion that the OEB likely does have the jurisdiction to create some form of expansion fund that creates subsidies between utilities and their ratepayers. The OEB's objectives for natural gas include the facilitation of competition in the sale of gas to users, and the facilitation of the rational expansion of transmission and distribution systems. As per the Toronto Hydro decision, rational gas expansion is a valid statutory purpose, and the OEB has been given a broad grant of power through its just and reasonable rates powers to promote this goal. If the OEB determines that an expansion fund is a reasonable way to promote rational expansion, then section 36 (when combined with the OEB's objectives) appears to provide that power....

Similarly, in order to justify a subsidy, the OEB must be satisfied that an expansion fund is in fact a "rational" means of expanding gas service and facilitating competition. The OEB will need to consider the expert economic evidence that has been filed in this proceeding, and consider the alternate proposals that do not require a cross-utility subsidy to make this determination.

In Procedural Order No. 3, the OEB asked parties to consider what changes to the OEB's jurisdiction might be helpful to encourage natural gas expansion. As discussed in further detail below, OEB staff believes that the existing legislative framework provides the OEB with the tools it needs to encourage natural gas expansion, and that changes to the Act do not appear to be required. However, if the OEB were inclined to consider an aggressive expansion fund, then changes to the Act that specifically authorized that activity would be welcome.

Board Staff cautions, however, that there are likely jurisdictional limits on how far such a program could go. The Board's objectives also include the protection of the interests of consumers with respect to prices. The expansion funds that have been proposed would involve the transfer of many millions of dollars from existing customers to new customers, with little or no benefit accruing to the existing customers. Presumably there is some point where an explicit transfer of wealth of this sort ceases to be just and reasonable for existing customers.¹⁸

Both Union and Enbridge propose to limit the rate impacts for existing customers. Union would limit the rate impact to a maximum of two dollars per month for all community projects they undertake while Board Staff proposed a limit of one dollar per month. The

¹⁸ OEB Staff Submission, June 20, 2016, EB-2016-0004, Pages 13-14.

utilities justification for this amount is based on the Board 2016 decision on demand-side management (DSM) programs which held that a charge of two dollars per month was reasonable and balanced the benefits of energy efficiency with the additional cost to consumers.

Upon further consideration, EPCOR supports the School Energy Coalition (SEC) contention that the threshold established for DSM is of a different nature and therefore may not be appropriate for community expansion projects. Unlike natural gas expansion the DSM programs benefit all general service customers of the utility. In the case of natural gas system expansion, the new customers clearly benefit much more than existing customers.

Board Staff concludes that it is likely that no subsidy from existing customers is necessary to achieve rational system expansion. In EPCOR's view it is difficult to come to this conclusion at this point. Unfortunately, we do not know the level and purpose of Government funding. It may be that funding from surcharges only is not sufficient for project viability. Some degree of funding from existing customers, through an Expansion Reserve, may very well be necessary in order to ensure viability of an expansion project.

On the other hand, Board Staff argues that in the event the Board approves a system expansion program the rate impact should be limited to a maximum of one dollar per month. EPCOR agrees with this proposed limit.

[Further Considerations Relating to the Expansion Reserve](#)

Should the Board decide that subsidies from existing customers are appropriate, EPCOR continues to believe that a Province-wide expansion reserve is the best mechanism for implementation. Such an approach is contained in the evidence of Union sponsored report by London Economics Inc.

“An alternative approach to EPCOR's suggestion would be to distribute the costs of expanding the network via a jurisdiction-wide cross-subsidy paid by all ratepayers, or through implementation of a broad-based tax regime. This would avoid undue burden on a single utility's customer base, while recognizing the wider environmental and economic benefits that may be accrued through investment in a public good.”¹⁹

Furthermore, that evidence also notes that internal cross-subsidization, as proposed by Union, would limit competitive entry:

“Requiring natural gas ratepayers to pay their own expansion costs, or allowing for internal cross-subsidization, may limit the incentives for new entry or expansion of other distributors into certain areas.”²⁰

¹⁹ Union Gas, Prefiled Evidence, March 21 2016, EB-2016-0004, Schedule 1, page 35.

²⁰ Union Gas, Prefiled Evidence, March 21 2016, EB-2016-0004, Schedule 1, page 14.

Thus, in the event that the Board decides against cross-subsidization, all forms internal or external should be prohibited. In this connection, even the portfolio approach which results in some cross-subsidies, is called into question.

Summary

1. The Board has the necessary jurisdiction to set these rates.
2. The Board has the necessary jurisdiction to establish an Expansion Reserve Fund.
3. The maximum term should be ten years.
4. The maximum bill impact should be \$1.00 per month.
5. The proceeds should be administered by the Board.
6. No proceeds can be distributed to any expansion market without a Board Order.
7. The Board Order should specify the amount, the recipient utility and the benefitting Municipal franchise.
8. All Ontario gas distributors that hold a franchise agreement and CPCN certificate for an expansion market are eligible to receive the funds.
9. All funds received are classified as an aid to construct.

F. Municipal Contributions

Both Union and Enbridge argue that Municipalities should make an annual contribution equal to the tax revenues that would result from the new pipeline construction. All parties appear to agree but differ on the term. Enbridge and Union propose ten years while Board Staff argues for 20 years or a term equal to the term of the new customer contribution.

EPCOR agrees with Board Staff and is of the view that the maximum term for new customer surcharges should at minimum be 20 years and if warranted could be extended to a maximum of 40 years for municipal contributions.

Summary

1. Municipalities should contribute an amount equal to the taxes resulting from the new natural gas facility.
2. The maximum term for such contributions should be negotiated and may be up to forty years.

G. Government Contributions

EPCOR believes that it is important that the Board make recommendations regarding government contributions. Union takes a different view and suggests that the Board simply leave that issue up to the utilities to deal with privately. Without some coordination this proceeding may not achieve its intended objective, i.e., to develop a process for facilitating expansion of natural gas services.

It is EPCOR's view that a rational national natural gas expansion program in Ontario cannot be successful without government contributions in the order that the government has already promised. This would be particularly the case if the Board elected not to require existing customers to make a contribution. In LPMA's submissions, LPMA puts forth a number of recommendations.²¹ The recommendations LPMA makes with respect to changes in the capital cost allowance and HST should be seriously considered by the Board as such changes will positively impact the economics of expansion projects and would make a difference to the economics of these projects.

Summary

1. The Board should make recommendations regarding Government contributions.
2. The Government grants and loans should be directed to reducing the aid to construct.

H. Franchise Agreements: A New Competitive Framework

Franchise Competitiveness

With the notable exception of the incumbents, there seems to be broad support for ensuring that expansion of gas infrastructure to unserved areas faces competitive pressures. Board Staff submissions are supportive of competitiveness.²²

Union's evidence and argument makes no mention of the benefits of competitiveness or of the large literature on 'competition for the franchise'.

Union's argument repeatedly attempts to link "competition" with a "global subsidy",²³

²¹ LPMA Submissions, June 20, 2016, EB-2016-0004, Page 13.

²² "OEB staff agrees with Dr. Yatchew that competition for the natural gas market could bring benefits to consumers by means of allowing for innovative service offerings, or alternative business models which could lower prices or allow certain projects to proceed where more conventional approaches to system expansion have failed to be economically feasible. OEB staff believes that a bidding process would be a means to promote the public interest through competition for the community expansion natural gas market." OEB Staff Submission, June 20, 2016, page 30.

²³ Union Gas Submissions, June 20, 2016, EB-2016-0004, Para. 9 iii, Pages 3-4; Para. 60-75 pages 24-29.

implying that the former cannot exist without the latter. There is a fundamental deficiency in this rhetorical convolution: ‘global subsidies’ presently exist in both the natural gas and electricity industries in Ontario; and, meaningful competition for franchises can take place in the absence of a global subsidy, so long as barriers to entry, including those erected by Union, are eliminated.

Much of Union’s evidence and argument can be understood within the perspective of its interest in preserving and expanding its monopoly. While, arguably, the presentations of all hearing participants are self-interested, EPCOR’s positions regarding competitiveness align with the public interest.

Pre-Qualification of a Pool of Potential Proponents

Board Staff submissions propose criteria for pre-qualifying candidates that may compete for new franchises based on technical and financial capability. EPCOR is in agreement with those criteria which include experience with constructing and operating a distribution system (or put another way experience with linear and utility retail based assets).

However, considerable discussion took place during the proceedings regarding the requirement for submissions on rates by proponents during the franchise application process. EPCOR has dealt with this argument at length.²⁴

EPCOR has taken the position that determination of rates at this early stage is meaningless given the uncertainties regarding sources of funds and contributions, notably from the Provincial Government and the absence of critical capital cost information, such as reinforcement costs, routing confirmations, EIA studies etc. The same argument would follow if pro-forma rates and rate structures are used by municipalities as a criterion when awarding franchises. Board Staff in its list of qualifying criteria have included “Pro-forma rates and rate structures”.²⁵ Any reliance on the pro-forma rates during franchise hearing as eligibility criteria would also unnecessarily deviate the focus away from qualifications into a premature rate application.

As noted earlier, EPCOR does not support consideration of rates at the franchise approval stage. This has not been the case in previous proceedings of this type, nor would there be adequate information to determine rates at this stage, particularly since the levels of Government support or other potential sources of funds (such as from the Expansion Reserve) would not be known at this time, nor would all of the capital costs.

²⁴ See section B. Base Rates in Expansion Markets.

²⁵OEB Staff Submission, June 20, 2016, EB-2016-0004, Page 33.

Summary

1. The Board should encourage Municipalities to undertake an open and fair selection process.
2. Municipalities should be required to issue a Public Notice when seeking a franchisee.
3. Municipalities should be responsible for selecting the proponent.
4. All existing and new franchise agreements should terminate if construction of facilities has not commenced in three years.
5. Municipalities should be able to charge a franchise fee at minimum for a term equal to the period for which they provide a tax rebate provided this can be demonstrated as a net gain for the rate payer

I. Conclusions

The Government of Ontario has made a decision that it is in the public interest to expand natural gas service to Ontario communities that are not currently being served. The Government has also asked the Board to investigate whether changes in the regulatory process currently applied to expansion projects could help the Government meet this goal.

Natural gas expansion projects are complex. Many jurisdictions have faced this issue and implemented programs with different degrees of success. Union and Enbridge have, with minor differences, offered one proposal. EPCOR, a new entrant into the Ontario natural gas distribution business, has offered a second proposal. The EPCOR proposal is very different from that of Union and Enbridge, as is highlighted in the attached comparison table.

EPCOR believes that the Ontario program can be successful but EPCOR does not believe this program can achieve success under the proposals advanced by Union and Enbridge. EPCOR contends that unlike the utility-specific proposals offered in this proceeding, EPCOR's recommendations offer a more balanced approach that has a much greater chance of bringing significant benefits to expansion communities.

ALL OF WHICH IS RESPECTFULLY SUBMITTED
DATED AT Toronto, July 11, 2016

Gordon E. Kaiser, Counsel for EPCOR Utilities Inc.

Appendix: COMPARISON TABLE

PROPOSAL	UNION	ENBRIDGE	EPCOR
Existing Customer Surcharge -- Rate	Max. \$24/year	Max. \$24/year	Max. \$12/year
Existing Customer Surcharge -- Term	10 years	10 years	10 years
Existing Customers Charged	All Union Customers	All Enbridge Customers	All Natural Gas Customers
Administration	Union	Enbridge	OEB
New Customer Surcharge -- Rate	\$0.23/m ³	\$0.23/m ³	\$0.23 /m ³ *
New Customer Surcharge -- Term	Max. 10 years	Max. 40 years	Min 10 yrs. Max.40 yrs.
New Customers Charged	General Service Only	All	All
Treatment of Surcharge	Revenue	Revenue	CIAC
Minimum Profitability Index	0.4	< 0.4	1.0**
Base Rates	Postage Stamp	Postage Stamp	Cost of Service
Community Expansion Deferral Account	Yes	Yes	No
Expansion Risk Shared by Utility	No	No	Yes
IRM Capital Pass Through	Yes	Yes	Yes
LNG Cost Allowance	Yes	Yes	Yes
Advance Reinforcement Costs Paid by Entrant	Yes	No	No
Bundled Rate Offerings Incorporating Conversion Costs	No	No	Yes
Government Contribution	No	No	Yes
Government Contribution -- Amount	NA	NA	Sufficient to achieve PI of 1 after inclusion of surcharges
Municipal Contribution	ITE	ITE	Rebate

*Or such higher rate as Board approves, set to achieve PI=1.0. ** After inclusion of all contributions and surcharges.