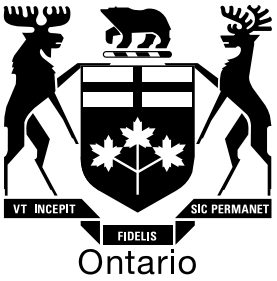

ONTARIO ENERGY BOARD

OEB STAFF SECOND ROUND OF SUBMISSION

Ontario Energy Board Proceeding
On Natural Gas Community Expansion
EB-2016-0004

July 11, 2016

1. Background

The Ontario Energy Board (OEB) initiated a generic proceeding in January 2016 to establish a common framework to facilitate natural gas distribution services in communities that do not have access to natural gas. The details and genesis of the generic proceeding were provided in the first round of OEB staff submission.

In Procedural Order No. 3 issued on May 30, 2016, the OEB scheduled two rounds of submissions. Accordingly, OEB staff filed a submission on June 20, 2016. In that submission, OEB staff discussed the various issues that were pertinent in the proceeding including a response to the legal question of whether the OEB had jurisdiction to establish a common fund that creates subsidies between utilities and their ratepayers.

OEB staff also proposed an alternate framework to facilitate community expansion that attempted to create a balance between existing ratepayers, new customers and other stakeholders. OEB staff has had the benefit of reviewing other parties' submissions and believes that its proposed framework creates the appropriate balance between existing customers' interests and the desire to expand gas distribution services in communities that are not served. OEB staff restates the alternative framework as described in its original submission:

- To implement the Expansion Surcharge for a maximum period of 40 years or until the project reaches a PI of 1.0.
- A contribution from municipalities that is equivalent to the incremental property taxes on the expansion infrastructure for a maximum term of 20 years or matching the term of the expansion surcharge.
- All community expansion projects should be included in the Rolling Project Portfolio as per the current E.B.O. 188 Guidelines. The minimum RPP would remain at 1.0 but the individual threshold for community expansion projects would be reduced to 0.7 (inclusive of expansion surcharge and ITE contribution) from the current 0.8. OEB staff also proposes that the Investment Portfolio guideline be reduced to 1.0 from the current 1.1.
- A capital pass-through mechanism to incorporate the community expansion projects in rates immediately following their in-service dates.
- Accounting orders to establish a Community Expansion Project Deferral Account and a Community Expansion Contribution Deferral Account. Staff prefers that the

amounts are cleared through a deferral account as compared to Enbridge's proposal of including it in rates on a forecast basis. The deferral account would capture actual revenues and costs which would reduce the forecasting risk for both, ratepayers and the utility.

2. Review and Response to Other Parties' Submissions

OEB staff has reviewed the submissions of other parties and has responded below to some of the issues raised by the parties.

London Property Management Association

Union Community Expansion Deferral Accounts

London Property Management Association (LPMA) has submitted that the OEB should reject the two deferral accounts sought by Union Gas Limited (Union) in the proceeding[1].

Union is seeking the Community Expansion Project Deferral Account. This account will be used to capture any variances between the forecast revenue requirement approved in rates and the actual revenue requirement for all community expansion projects, including timing differences between the in-service dates and the inclusion in rates. LPMA has submitted that this will reduce Union's risk associated with the net revenue requirement to zero and there would be no incentive for Union to control its capital expenditures.

OEB staff does not agree with LPMA. Deferral accounts are fairly common for regulated utilities. Union has several OEB approved deferral accounts, many of which are designed to track the difference between the actual revenue requirement associated with major capital projects and the revenue requirement that is included in rates. This includes the Parkway West Project Costs deferral account, the Brantford / Kirkwall / Parkway D Project Costs deferral account, and the Lobo C Compressor / Hamilton-Milton Pipeline Project Costs deferral account. Moreover, any excess expenditure over the forecast would be reviewed for prudence.

The second deferral account referred to in LPMA's submission is the Community Expansion Contribution Deferral Account. LPMA has submitted that this reduces Union's risk and there is no incentive to forecast accurately.

[1] LPMA Submission, Page 10

OEB staff notes that Union has several deferral accounts that are symmetrical and protect the interests of both ratepayers and the utility. One such account is the Normalized Average Consumption (NAC) Deferral Account, which records the variance in delivery revenue, storage revenue and costs resulting from the difference between the target NAC included in OEB-approved rates and the actual NAC for general service rate classes. There are a number of other deferral accounts that are also symmetrical and do not favour the utility or the ratepayers, they track the difference between actual and forecast. In other words, it not only reduces Union's risk but also ratepayers' risks.

OEB staff further note that Union's attachment forecast is fairly conservative when compared to Enbridge's[2]. Moreover, a utility has to forecast some attachment rates in order to test the economic assumptions and if there is sufficient evidence that the forecast has been developed prudently then the utility should be provided the required protection in case the forecasts do not materialize.

OEB staff therefore is of the opinion that the deferral accounts being requested by Union should be approved under an alternate framework that may be established by the OEB.

Treatment of Surcharges as Revenue

Union and Enbridge have proposed that the expansion surcharge payments be treated as revenue rather than as a contribution in aid of construction (CIAC). LPMA has submitted that the surcharge payments should be treated as CIAC. This view is supported by other parties including Consumers Council of Canada (CCC), School Energy Coalition (SEC) and the Federation of Rental-housing Providers of Ontario.

LPMA has rejected Union's claim that ratepayers are better off if the payments are treated as revenue rather than CIAC. LPMA has provided calculations to support its submission using Union's Milverton Project as an example. LPMA has noted that the sum of the total revenue requirement over the 40 years is $14.8 million under the revenue approach and $11.8 million under the CIAC approach. In other words, over 40 years, customers would pay $3 million more in rates for the Milverton Project under the Union proposal[3].

OEB staff understands the premise of LPMA's submission on the issue noted above and supports it in principle. However, CIAC is normally a lump sum payment that is

[2] OEB Staff Submission, Page 35
[3] LPMA Submission, Page 12

provided to a utility prior to the construction of the project. They are not payments over an extended period. The utilities have proposed to include the expansion surcharge in the monthly bill as a line item. In other words, it is just like other revenue that the utility receives – monthly charges, delivery rates, commodity costs etc. The formulation of the surcharge is such that it is more appropriate as a revenue item.

In addition, treating surcharges as CIAC would create an inequity between incumbent utilities and new entrants. The incumbent utilities have proposed surcharges mainly because they have to charge rates as per existing rate schedules. If the incumbent utilities had the flexibility to charge different rates, they would have incorporated the surcharge to existing rates. Conversely, a new entrant would use a cost of service model to calculate its rates and these rates would be derived from the entire capital cost of providing service in the new communities. In other words, the surcharge would be bundled in the new entrant's distribution rates. Affording different treatment to the incumbent utilities and new entrants would not be an appropriate ratemaking approach.

Capital Pass-Through Mechanism – Union Gas

Union and Enbridge have requested that they should be allowed to recover the revenue requirement associated with the community expansion projects in rates during the remainder of the Incentive Ratemaking (IRM) framework once the assets are used and useful.

OEB staff in its submission did not oppose this request. However, LPMA has opposed this request along with CCC, SEC, Parkland Fuel Corporation and EPCOR Utilities Inc.

LPMA in its submission noted that very few community expansion projects will be placed into service by the end of 2017 and 2018. The resulting net revenue requirement is therefore not likely to be material.

In addition, LPMA has submitted that the community expansion projects of Union would not qualify as a Y factor for major capital additions and a Z factor for unanticipated events as per the Union EB-2013-0202 (IRM framework) Settlement Agreement. LPMA notes that projects other than Kincardine would not meet the required threshold for a Y factor and the projects would not qualify as a Z factor given the net revenue requirement threshold. LPMA has further noted that the Kincardine project is not likely to be in service before the end of 2018.

LPMA has argued that Union is essentially requesting a change to the IRM Settlement Agreement by allowing a new cost to be included in rates that does not qualify for inclusion based on the agreement. LPMA has submitted that it would not be appropriate

for the OEB to make a change to the agreement without the consent of all the parties to that agreement.

LPMA has further submitted that it is not totally opposed to the inclusion of the net revenue requirement associated with the community expansion projects in rates for 2017 and 2018. However, any agreement should be conditional on negotiating other changes with Union and other parties to the EB-2013-0202 Settlement Agreement.

The Industrial Gas Users Association (IGUA) and the Ontario Geothermal Association (OGA) have made a similar observation in its submission. However, IGUA does support the inclusion of the revenue requirement associated with community expansion projects during the existing IRM period. IGUA has further noted that while the OEB could approve Enbridge Gas Distribution's (Enbridge) request for a capital pass through, the approval of Union's request for a similar treatment could be complicated. IGUA further acknowledges that approving Enbridge's request while denying Union's would effectively penalize Union for having reached a settlement rather than litigating its current IRM plan[4]. IGUA was therefore prepared to endorse affording Union the same regulatory flexibility in support of the government's stated policy favouring rational natural gas system expansion.

OEB staff acknowledges that while the OEB will be able to approve Enbridge's request for capital pass through for community expansion projects during the IRM period, the same may not be straightforward for Union. OEB staff recommends that the OEB canvass the parties that were signatories to the EB-2013-0202 Settlement Agreement on the issue, but in the end OEB staff is of the view that the OEB has the authority to decide that a capital pass through is appropriate.

School Energy Coalition

The School Energy Coalition (SEC) has submitted that the OEB should keep a comprehensive database of existing Franchise Agreements, and maps of where natural gas service is currently provided. According to SEC, this would be a simple way to eliminate some of the informational barriers that new entrants face. The OEB could also keep a registry on its web site of all potential companies that may be interested in serving expansion communities. This information would be beneficial to unserved

[4] IGUA Submission, page 17

communities to know the number of proponents interested in providing gas distribution services[5]. Other parties including EPCOR Utilities Inc. made similar suggestions.

OEB staff submits that the suggestion of SEC is a good one and the OEB should consider adding to its website a database of existing Franchise Agreements and a registry of potential companies that may be interested in serving expansion communities.

EPCOR Utilities Inc.

EPCOR Utilities Inc. (EPCOR) has submitted that a strict and narrow definition of community is neither necessary nor desirable if the objectives of rational natural gas expansion are to be achieved in the Province[6]. EPCOR is of the view that the proponents should have the discretion to put forth details of the target community. Parkland Fuel Corporation and the NOACC Coalition expressed similar views.

OEB staff agrees with the above views assuming that no cross-subsidization is required. However, in a scenario where the OEB approves some kind of subsidies flowing from existing to new customers in the communities, some criteria and parameters will need to be established. Irrespective of the definition established, OEB staff is of the view that projects with a higher Profitability Index should proceed first.

With respect to surcharges, EPCOR has submitted that distributors should have the flexibility to offer bundled rates which combine gas costs with utility based financing of capital costs of conversion to natural gas, in particular the purchase of boilers or furnaces[7]. EPCOR has compared this to the telecom industry where customers purchase cellular phones as part of a service plan with low up-front charges.

OEB staff notes that this approach was not discussed in EPCOR's evidence or at the oral hearing. Consequently, parties did not have an opportunity to ask questions or test the above approach. Nevertheless, OEB staff notes that the OEB has required utilities to provide a fair amount of transparency in customer bills clearly separating commodity and distribution rates. The OEB also required the utilities (Union and Enbridge) to divest their equipment rental business from the regulated utility in early 2000 as part of an initiative to remove any competitive advantages enjoyed by the utilities vis-à-vis other companies that provided such services. Allowing utilities to re-enter the business in some other fashion would not be appropriate. However, if the OEB were to introduce

[5] SEC Submission, section 4.2.3, page 41
[6] EPCOR Submission, page 48
[7] EPCOR Submission, page 52

some form of on-bill financing that would provide customers the ability to pay a monthly charge in their utility gas bills for conversion equipment, OEB staff would support such an approach.

Canadian Propane Association

In its application, Enbridge has identified a subset of communities that it intends to serve using Liquefied Natural Gas (LNG). Enbridge has proposed to recover the cost of LNG from all customers through the company's gas supply plan. OEB staff in its original submission opposed Enbridge's proposed approach of requiring all customers to pay for the cost of LNG supply. OEB staff submitted that communities that are served using LNG should pay the costs to serve them and there is no reason why new customers should not pay the actual cost of the commodity.

The Canadian Propane Association (CPA) in its argument opposed an approach where the OEB would pick winners and losers among two competing energy suppliers by allowing subsidies for one and not the other. The CPA submitted that with respect to the LNG service, LNG trucks would be essentially competing with propane trucks to serve the same customers. If subsidies are provided to LNG, the propane business could be severely impacted. CPA submitted that the fact that propane delivery trucks and distribution centres can profitably operate without a subsidy suggests that LNG delivery trucks should also be able to operate without a subsidy[8].

OEB staff agrees with the above rationale and reiterates its position that any LNG project pursued by the utilities should not include a framework where the cost of LNG is subsidized for new community expansion customers.

The OEB's jurisdiction to implement an expansion fund (Issue #2)

OEB staff has reviewed all of the submissions relating to the OEB's jurisdiction to implement an inter-utility subsidy. The parties that addressed this issue are almost evenly split: 8 parties (including OEB staff) believe the OEB does have the jurisdiction, and 7 believe that it does not.[9] Irrespective of their final position, the parties all referred to essentially the same cases. It is fair to say that there is considerable debate regarding the OEB's jurisdiction, and that the "answer" to issue #2 is not straightforward.

[8] CPA Submission, page 5
[9] OEB staff, VECC, EPCOR, Greenfield, South Bruce, SEC, NOACC and OPI generally argued in favour of the OEB's jurisdiction, though some of the parties believed there were limits on how extensive the cross subsidy could be. Anwaatin also mentioned in passing that it thought a universal service fund was appropriate, but it did not analyse the issue further. Parkland, CCC, BOMA, LPMA, CPA, Union and Enbridge argued that the OEB does not have the required jurisdiction.

Although OEB staff does not agree with all of the submissions that were filed, we believe that the positions are generally well researched and provide a thoughtful analysis of a difficult issue. For the most part OEB staff is content to rely on its initial submission, and will not be undertaking a point by point rebuttal of the other parties' submissions.

There is one major argument under issue #2 that was raised by CPA that was not addressed in OEB Staff's initial submission: the question of whether an expansion fund would constitute a "tax". The power to impose a tax must be provided through clear and unambiguous statutory language, which the OEB Act does not contain in CPA's argument. CPA therefore concludes that the OEB has no jurisdiction to create an expansion fund.

CPA asserts that the Supreme Court has established a four part test to determine what constitutes a tax: a) it is enforceable by law, b) it is levied by a public body, c) it is intended for a public purpose, and d) it is imposed under the authority of the legislature.[10] CPA argues that a cross-utility subsidy would meet the first three elements of the test, but would fail the fourth as it would not be imposed under the authority of the legislature. CPA states that since the OEB Act does not contain "clear and unambiguous" provisions allowing it to impose a tax, the OEB therefore does not have the jurisdiction to create an expansion fund of the type proposed by Epcor (i.e. funded through cross utility subsidies).

OEB staff does not agree that a cross utility subsidy would amount to a tax. The test for what constitutes a tax was amended by the Supreme Court in *Westbank First Nation v. British Columbia Hydro and Power Authority* (Westbank) to provide a fifth element: is the charge unconnected to any form of regulatory scheme?[11] If the answer to that question is yes (i.e. the charge is in fact related to a regulatory scheme), then the charge in question will be considered a valid regulatory charge, and not a tax. OEB staff submits that – to the extent that the OEB created an expansion fund to promote rational gas expansion in Ontario – this subsidy would properly be characterized as a regulatory charge and not as a tax.

The distinction between a valid regulatory charge and a tax is important. Whereas a tax requires clear and unambiguous authorization from the legislature (for example through the OEB Act), a regulatory charge does not. The key distinction between a tax and a regulatory charge is whether the revenues raised are used for general purposes or dedicated to a specific regulatory purpose. In the words of the Supreme Court: "the

[10] *Re Eurig Estate*, [1998] 2 SCR 565, at para. 15.
[11] Westbank, 1999 CanLii 655, para. 43.

central task for the court is to determine whether the levy's primary purpose is, in pith and substance: (1) to tax, i.e., to raise revenue for general purposes; [or] (2) to finance or constitute a regulatory scheme, i.e., to be a regulatory charge or to be ancillary or adhesive to a regulatory scheme".[12]

Determining whether something is a regulatory charge (as opposed to a tax) involves a two-step test, as established by the Supreme Court in the cases Westbank and *620 Connaught v. Canada* (Connaught): 1) is there a "regulatory scheme" in place, and 2) is there a connection between the charge (in this case a rate) and the regulatory scheme.[13] If a charge/fee/rate passes this two part test then it is properly considered a regulatory charge, and as such would be within the authority of the OEB to impose.

In considering whether there is a regulatory scheme in place, the Supreme Court has identified four factors to consider: (1) a complete, complex and detailed code of regulation; (2) a specific regulatory purpose which seeks to affect the behaviour of individuals; (3) the existence of actual or properly estimated costs of regulation; and (4) a relationship between the regulation and the person being regulated, where the person being regulated either causes the need for the regulation or benefits from it.[14] It is important to note that these factors are meant to serve as a guide, and not all four factors need be present.[15]

OEB staff submits that there is a regulatory scheme in place; generally with respect to the regulation of the gas industry and more particularly with respect to encouraging the rational expansion of gas service. There is no question that the OEB administers a statutorily authorized and complex system of natural gas regulation. The OEB has exclusive regulatory jurisdiction over most elements of Ontario's natural gas sector, including rate setting, franchise agreements, and major facilities construction. Clearly there is a comprehensive regulatory scheme in place with respect to the natural gas sector. This scheme includes the facilitation of the rationale expansion of the natural gas transmission and distribution networks. The funds raised for the expansion fund would presumably all be dedicated to promoting gas expansion. To the extent that the OEB finds that an expansion fund is a rational means of facilitating expansion, OEB staff submits that rates designed to fund such a program would form part of a comprehensive regulatory scheme.

OEB staff further submits that there would be a strong relationship between any rates authorized to fund an expansion fund and the regulatory scheme. Although there are a

[12] Westbank, para. 30.
[13] Westbank, para. 43; Connaught, 2008 SCC 7 (CanLii), para. 19.
[14] Westbank, para. 24; Connaught, para. 25.
[15] Westbank, para. 26.

number of ways in which an expansion fund could be designed and administered, the most likely means would be through some type of rate surcharge. Money collected through this surcharge would be used more or less directly to subsidize or otherwise fund gas expansion. The connection between the rate and the regulatory scheme seems clear.

It is OEB Staff's view, therefore, that an expansion fund would meet the two part test established in Westbank and Connaught. An expansion fund would properly be considered a valid regulatory charge, and not a tax. Subject to our comments in our initial submissions, OEB staff believes that the OEB has the jurisdiction to enact an expansion fund.

Even if it is not considered a regulatory charge, the OEB Act arguably does provide clear and unambiguous language authorizing a cross utility subsidy. The Act clearly empowers the OEB to set just and reasonable rates, and as OEB staff (and others) discussed in its initial submissions, this is a very broad power. When coupled with the statutory objective of facilitating the rational expansion of the gas transmission and distribution systems, this arguably is a clear and unambiguous authorization to impose a cross utility subsidy. As the ATCO case establishes that the OEB is empowered to create income based rates through its just and reasonable rates powers, and the Divisional Court apparently did not have any concerns about this amounting to a tax. A cross utility expansion fund is in theory very similar.

Ontario Sustainable Energy Association and Environmental Defence

The Ontario Sustainable Energy Association (OSEA) has submitted that the utilities should be required to provide an assessment of alternative options to natural gas, including sustainable energy technologies. OSEA rejects the views of the utilities that they might not be qualified to perform the assessments[16]. Environmental Defence has made a similar argument. Environmental Defence submitted that the utilities should be required to provide more information about alternatives in their leave to construct applications. A comparison of alternatives would need to include renewable energy (e.g. geothermal) and non-gas conservation even though the utilities do not provide such services[17].

The utilities are in the business of gas distribution and their evidence should provide information about the feasibility and economics of providing gas distribution services in

[16] OSEA Submission, paras. 37 and 38, page 10
[17] Environmental Defence Submission, paras. 27 and 28, page 10

specific communities. On that basis, OEB staff submits that they should not be required to provide detailed assessments of alternative technologies such as solar and geothermal. Any party that wishes to discuss other alternative technologies can bring such information for the consideration of the OEB in the individual community expansion applications. However, OEB staff agrees that the utilities are required to consider Demand Side Management (DSM) initiatives in the context of infrastructure planning as an alternative as noted in the OEB's Report on DSM Framework for Natural Gas Distributors[18]. The OEB in its Report directed utilities to consider the role of DSM in reducing and/or deferring future infrastructure investments in advance of infrastructure replacement or upgrade so that DSM can reasonably be considered as a possible alternative. It is OEB staff's view that while DSM is important to ensure the most efficient use of natural gas, it can reduce the capacity required of a pipeline, not replace the pipeline in its entirety.

Ontario Geothermal Association

The Ontario Geothermal Association (OGA) in its submission noted that the use of natural gas for space and water heating must decline over the next 35 years if the province of Ontario is to meet the Greenhouse Gas emission reduction targets in 2020, 2030 and 2050. OGA has therefore recommended that the OEB impose a moratorium on community expansion applications by utilities until they prepare and present to the OEB for review, their strategy to achieve the goals of the Province's Climate Change Action Plan.

OEB staff does not agree with the recommendations of OGA. The Ontario Government is committed to pursuing options to expand natural gas infrastructure to service more communities in rural and northern Ontario as indicated in the Minister's February 17, 2015 letter to the Chair of the OEB. The Government has confirmed this intent with the establishment of a $230 million loan and grants program. Further, the Government has not rescinded this objective after the introduction of the Climate Change Action Plan. In fact, the Climate Change Action Plan notes that homeowners and businesses will have continued access to natural gas.

OEB staff therefore submits that the OEB should proceed with the current application as intended and establish an alternative framework to expand natural gas services if it wishes to do so. OEB staff further note that the OEB has confirmed through the Issues

[18] Report of the Board – Demand Side Management Framework for Natural Gas Distributors (2015-2020), EB-2014-0134, December 22, 2014

List that it will consider the climate change policies of the Government in this proceeding and any alternative framework that it may establish.

– All of which is respectfully submitted –