Jay Shepherd
Professional Corporation
2200 Yonge Street
Suite 1302
Toronto, ON M4S 2C6

BY EMAIL and RESS

July 11, 2016
Our File: EB20160004

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2016-0004 – Natural Gas Community Expansion – SEC Reply Argument

We are counsel to the School Energy Coalition ("SEC"). Pursuant to Procedural Order No. 3, please find SEC's Reply Argument.

Yours very truly,
Jay Shepherd P.C.

Original signed by

Mark Rubenstein

cc: Wayne McNally, SEC (by email)
All parties (by email)

T. (416) 483-3300 F. (416) 483-3305

mark.rubenstein@canadianenergylawyers.com
www.canadianenergylawyers.com

EB-2016-0004

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act*, *1998*, S.O. 1998, c.15, Schedule B;

AND IN THE MATTER OF an 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 ARGUMENT
OF THE
SCHOOL ENERGY COALITION

July 11, 2016

Jay Shepherd P.C.
2200 Yonge Street, Suite 1302
Toronto, ON M4S 2C6

Mark Rubenstein
Tel: 416-483-3300
Fax: 416-483-3305

Counsel for the School Energy Coalition

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1 OVERVIEW

1.1.1 On June 20th, the School Energy Coalition ("SEC") filed its Final Argument concerning the Ontario Energy Board (the "Board") initiated proceeding to consider generic issues regarding the expansion of natural gas to existing rural, remote, and First Nations Communities (referred to broadly in these submissions as "unserved communities"). SEC has reviewed the extensive arguments filed by other parties, and this is our reply to those submissions.

1.1.2 SEC still does not oppose the Board making *some* changes to EBO 188, or granting exemptions from it, for the purpose of expanding natural gas service to unserved communities. However, the regulatory flexibility that should be granted should be limited, and must ensure the conditions previously set out in SEC's Final Argument are met.

1.1.3 The Board must balance the benefits of expanding to unserved communities with the harms to existing customers. An overall cross-subsidy should be the last resort. But if one is to be required, it should be done on a jurisdiction-wide basis to help offset the harms, by promoting competition and protecting consumers with respect to price.

2 CHANGES TO EBO 188

2.1.1 There appears to be general agreement among the parties on the concept of allowing utilities to charge surcharges from new customers, or to require municipal contributions (incremental tax equivalent) from their communities. The disagreement appears to be with altering the Profitability Index ("PI") requirements under EBO 188. Many parties have taken the view that no changes to the EBO 188 economic feasibility calculation should be allowed, and others, that any changes should not allow for any overall cross-subsidies from existing customers to new customers by allowing expansion projects that lower the overall investment and rolling portfolio below a PI of 1.0.

2.1.2 SEC submits this position takes a much too narrow approach to what is an economically rational expansion. As Enbridge rightly points out, the Board has previously said, with respect to transmission expansion, that in certain circumstances it is appropriate to

approve projects that raise rates for non-sustaining extensions.[1] While the goal should be to keep the overall expansion PI to at least 1.0, if that is not possible, the expansion projects may still be appropriate, but that only applies if the benefits to those communities and the province (Stage 2 and 3) substantially outweigh the cost to existing customers. This has been the approach the Board has taken with regards to transmission expansion under EBO 134 (incorporated into the Filing Guidelines for Economic Transmission Pipelines – EB-2012-0092). While there are differences, no party who opposes this approach has explained why the concept is acceptable for transmission expansion but not at all for distribution expansions.

2.1.3 But any subsidy that is authorized must result in only modest rate impacts to existing customers. The proposals of each of Union, Enbridge and EPCOR result in significant rate impacts. The $24 a year for an average residential customer for community expansion is too much to ask ratepayers. It works out to 6-7% increase in delivery rates for Union customers[2] and would be similar for Enbridge. For schools alone, that will be millions of dollars over the life of the program. SEC submits no more than a 2% of the delivery bill (as opposed to total bill) at any one time for all customer classes, as compared to the proposed $2/month, $24 /year proposal.

2.2 "No Overall Cross-Subsidy" Proposals

2.2.1 SEC agrees that cross-subsidies should be a last resort to trying to achieve the goal of lower energy costs for unserved communities. What any framework must ensure is that the proper balance is created. Some parties argue that the flexibility the Board should allow is to either remove or lower the individual project PI threshold, but still require the full investment or rolling portfolio to remain at a PI of at least 1. SEC agrees that this a preferable approach to expanding natural gas service to unserved communities as it avoids any overall cross-subsidies. The problem is that it's not clear how many additional new customers could be connected using that paradigm. Both Union and Enbridge have provided evidence that the rolling portfolio has had a combined positive NPV of $65M

[1] Enbridge Gas Distribution Inc. Argument-in-Chief ["Enbridge Submission"], para 17, quoting *Filing Guidelines on the Economic Tests for Transmission Pipeline Applications* (EB-2012-0092), Feb 21 2013, p.3
[2] Tr.5, p.76

over the last few years, which would allow for some additional expansion.[3] Enbridge refused to provide a specific number for projects that could go forward so the impact of this approach is unclear.[4] Union argues that this will have very limited impact on its ability to expand.[5]

2.2.2 The problem with elimination of a minimum project PI is that it would allow for some smaller, individually very uneconomic projects to go forward, while larger, less uneconomic projects would not be able to proceed. Board Staff's proposal is more appropriate. Instead of getting rid of the minimum project PI all together, the Board could reduce it.[6] If the Board does choose to undertake this approach, all the other criteria SEC has recommended should still apply. The Board should still require the project to be the most cost effective solution for the community, and should require that the project still brings positive overall benefits when stage 1 and 2 of EBO 134 are combined.

2.3 Ensuring Economic Feasibility Calculations Are Accurate Is Paramount

2.3.1 Many parties' submissions support SEC's view that it is of utmost importance, in any proposed changes to EBO 188, to get the economic feasibility calculations right. SEC agrees with the CPA that the utilities' previous forecast connection costs and conversion rates are unreliable.[7]

2.3.2 Those forecasts will become even harder to predict because there are further structural changes in the natural market, occurring primarily due to the Province's climate change policy. It will become much more economical for individuals to switch their heating source to new carbon neutral technologies. The Board must ensure that the utilities, whose self-interest is in highlighting potential customer's interest in the service they offer, not those provided by other technologies, are undertaking the proper analysis to demonstrate that natural gas is still the best option in a given community.

2.3.3 As SEC argued in its Final Argument, no natural gas expansion should occur if it is not

[3] Union Ex.1, p.8 14.6M; S3.EGDI.CCC.16 40M
[4] S3.EGDI.VECC.7; S3.EGDI.CCC.16
[5] Union Gas Ltd. Submissions ["Union Submission"], para. 38
[6] OEB Staff Submissions ["Board Staff Submission"],p.19, 23
[7] Submissions of the Canadian Propane Association ["CPA Submission"], para 69-70

the most cost-effective option. The OGA put it best when it said, "it is not 'rational expansion' to extend natural gas infrastructure if it is not the best option for the affected community".[8] This least-cost-planning approach requires the Board to take a more prescriptive approach, since the utilities have an obvious self-interest to favour natural gas as the solution. It is also not sufficient to look to past behaviors and economics to predict what will happen in the future. There are significant changes to the Ontario energy system due to cap and trade and the funds that are collected from it through the Climate Action Plan. Conversion rates and volume are likely to see significant change in the future. Alternative sources of energy will become more cost-effective and competitive with natural gas.

2.3.4 SEC agrees with OSEA that the Board should prescriptively require the assessment of not just older technologies (e.g. propane, electricity space heating, wood), but also new sustainable energy technologies.[9] While the utilities have stated that this is not easy for them because they are not experts, as OSEA rightly points out, such a claim is not credible for these large and sophisticated entities that have been given the authority by the minister, in some cases, to own some of these types of renewable energy facilities.[10] The easiest way to ensure the utilities do this is, as Environmental Defence has proposed, the Board should establish some specific filing guidelines.[11]

2.4 40-Year Time Horizon May Need To Be Revisited.

2.4.1 It is not just ratepayer and environmental groups that believe that there will be a significant impact on future demands caused by cap and trade and the Climate Action Plan. Union, after the end of the oral hearing in this proceeding, filed with the Board an application for leave to construct the Panhandle Reinforcement Project. In that application, Union is requesting the Board approve an asset's useful life as 20 years instead of the usual 50 years. Union's justification is that this reduced useful life of the pipeline "better aligns the cost with the timing of the reported restrictions and potential elimination of natural gas heating in homes and business" that is included in the Climate

[8] First Round Submissions of the Ontario Geothermal Association ["OGA Submission"], para. 4.5.1
[9] Written Submission of the Ontario Sustainable Energy Association ["OSEA Submission"], para. 35-40
[10] OSEA Submission, para. 35-40
[11] Submissions of Environmental Defence ["ED Submission"], para. 27

Action Plan.[12] It has conducted the EBO 134 analysis based on a 20 year time horizon.[13]

2.4.2 SEC submits that this calls into question the use of a 40-year time horizon for the economic feasibility calculations. Union's own evidence in that proceeding recognizes that there is a significant chance of stranded, or significantly underutilized assets after 20 years due to the Government's climate change policy, which favours a move away from natural gas.[14]

2.4.3 It may now be appropriate to use a much shorter time horizon for the economic feasibility calculation. At the very least, the Board should leave open the possibility that in an individual leave to construct, rates, or Certificate of Public Convenience and Necessity proceeding, it may be appropriate to reduce the time horizon of the feasibility calculation from the current 40 years.

2.5 Community Definition

2.5.1 Board Staff recommends that the definition of community should explicitly include a provision that specifies that it only includes existing customers "which cannot be served from the existing distribution system", as a reason to avoid subdivisions which are proximate to the current system.[15] SEC disagrees with this suggestion. It is not apparent why there should be a distinction between existing home or business that are close to a utility's system and those that are far from it. In both cases, there are existing premises under which expansion of service is currently considered uneconomic. What should be the determining factor if they are included under the framework is their *relative* economic feasibility.

2.5.2 The Southern Bruce Municipalities ("Southern Bruce")[16] suggests that the 50 customer limit may be too low if the point of the program is to reach the largest number of

[12] EB-2016-0186, Ex.A-3, p.7 (See Attachment A)
[13] EB-2016-0186, Ex.A-7, p.3 (See Attachment A)
[14] EB-2016-0186, Ex.A-3, p.6-8 (See Attachment A)
[15] Board Staff Submission, p.7
[16] In SEC's Final Argument we used the name South Bruce as the name of the Municipality of Kincardine, the Municipality of Arran-Elderslie and the Township of Huron-Kinloss. We understand now they prefer to be called the Southern Bruce Municipalities. See Southern Bruce Municipalities Written Submissions ["Southern Bruce Submission"], p.1, footnote 1

customers.[17] The goal of the program should be to bring service to the most new customers on a cost-effective basis, calculated per new customer. The number of forecast customers for any specific project is only relevant in drawing a distinction between a Community Expansion Project, and a Small Main Project, which have some funding differences.

3 JURISDICTION-WIDE SUBSIDY

3.1 Board is an Economic Regulator.

3.1.1 A number of parties oppose any explicit cross-subsidies[18], and others, just ones that are provided on a jurisdiction-wide basis.[19] They do so primarily by pointing to the Divisional Court's decision *Advocacy-Centre for Tenants v. Ontario Energy Board* ("*Advocacy-Centre"*) where the decision states that the Board is an economic regulator and should not be setting social policy.[20]

3.1.2 SEC agrees that the Board is an economic regulator, but it is equally clear from *Advocacy-Centre* that cross-subsidies are not necessarily a matter of social policy. If that was the case, the Divisional Court majority would have come to the complete opposite conclusion from what it did, that the Board has the jurisdiction to set differential rates based on income. What it requires is that rates be set on an economic basis, but in doing so, the Board has broad authority to determine any "method or technique do so", as long as its actions are in furtherance of its statutory objectives.[21]

3.1.3 A jurisdiction-wide model furthers the statutory objectives. It does so by facilitating competition in the sale of gas by not allowing only utilities with existing customer bases to provide cross-subsidies. It protects consumers with respect to price by spreading the cost of expansion over the entire Board regulated customer base equally, instead of differing amounts, and only to Union and Enbridge customers.

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[17] Southern Bruce Submission], para. 11-12
[18] Parkland Fuels Corporation Final Argument ["Parkland Submission"], para. 32; CPA Submission, para. 28; Written Submissions of the Industrial Gas Users Association (IGUA) ["IGUA Submission"], para. 34-36, OGA Submission, p.19, footnote 40
[19] Union Submission, para. 27
[20] *Advocacy Centre for Tenants-Ontario v. Ontario Energy Board*, [2008] OJ No. 1970 ["*Advocacy Centre*"], para. 40
[21] *Advocacy Centre* ["*Advocacy Centre*"], para. 55

3.1.4 As the Supreme Court said in *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, the purpose of rate regulation is to achieve the multiple goals of "sustainability, equity and efficiency". [22] Union and Enbridge proposals of intra-utility cross-subsidies do not achieve this. They are neither efficient nor equitable. Conversely, jurisdiction-wide subsidies do a better job achieving these goals.

3.1.5 SEC does accept that if the Board does not find there is an economic case and that these expansions are rational, then it has no basis to allow for a cross-subsidy. But that applies equally whether the mechanism is jurisdiction-wide or within the utility. SEC also agrees with Board Staff, that this does not give a blank cheque to allow for any level of cross-subsidy.[23] At some point the amount would be unreasonable and lead to rates that cannot be considered just and reasonable.

3.2 Cost of Service

3.2.1 A number of parties argue that that since the root principle of just and reasonable rate-making is still cost of service, it does not allow for one utility to be subsidizing another.[24] SEC disagrees insofar as the total amount charged to ratepayers in the aggregate (existing and new customers) is not in excess of the cost to serve them.[25] How the Board determines how to use that global amount to set rates becomes less of a legal question, and more a one of policy.[26]

3.2.2 Union argues that a jurisdiction-wide model offends many rate-making principles.[27]

3.2.3 First, Union argues that it is contrary to the benefits-follow-the-costs principle. SEC agrees that this is a fundamental rate-making principle, but any deviation from it goes more to the advisability of a jurisdiction-wide proposal, and not the Board's legal jurisdiction to order it. It is also hypocritical for Union to argue that the Board deviating from this principle is beyond the scope of the Board if a central component of its own

[22] *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, 2006 SCC 4, para. 62
[23] Board Staff Submission, para. 14
[24] Enbridge Submission, p.2; Parkland Submission, para. 28
[25] *Advocacy Centre*, para. 59
[26] *Newfoundland Telephone Co. v. Newfoundland (Board of Commissioners of Public Utilities),* [1992] 1 S.C.R. 623, para. 32; *Bell Canada v. Bell Aliant Regional* Communications, 2009 SCC 40, para. 48
[27] Union Submission, para. 23

proposal has the same problem. The difference with respect to the Union proposal is that the beneficiary of the cross-subsidy will just be different Union customers.

3.2.4 Second, Union points to the stand-alone principle and argues that a jurisdiction-wide model runs contrary to it. The stand-alone principle has little application here. It is about ensuring that costs and risks that pertain to activities of a regulated utility are reflected in the revenue requirements, as opposed to including unregulated costs and risks. In a jurisdiction-wide model, the costs are entirely regulated. It just may be a combination of regulated entities.

3.2.5 Third, Union argues that a jurisdiction-wide subsidy is in breach of the fair return standard. SEC submits that if the subsidy is treated as revenue, then that *may* be the case, but if it is treated similar to capital in aid of construction ("CIAC"), then it is not an issue. This is because under a CIAC regulatory treatment, there is no return on capital that is being funded by the subsidy provided in a general sense from customers of a different utility.

3.3 Express Authority Not Required

3.3.1 Union takes the position that since there is no express authority to create a jurisdiction-wide subsidy, the Board must find such power through the doctrine of necessary implication, which in its view, does present itself in this case.[28] Union argues that the legislature turned its mind to jurisdiction-wide subsidies and did not grant one from natural gas.[29]

3.3.2 The Board has explicit jurisdiction on the basis of the Divisional Court's decision in *Advocacy-Centre* where it found that, because it had jurisdiction to allow for the differing rates based on income, there was no need to consider the doctrine of necessary implication or the related principle of implied exclusion.[30] Moreover, there is simply no evidence of any kind that the legislature, when it enacted amendments to the *OEB Act*[31] to create jurisdiction-wide subsidy model provisions, such as the RRRP, or OESP, ever

[28] Union Submission, para. 15-17
[29] Union Submission, para. 17-18
[30] *Advocacy Centre*, para. 63
[31] *Ontario Energy Board Act*, 1998, S.O. 1998, c. 15, Sched. B ["*OEB Act*"]

turned its mind specifically to the issue of creating a similar natural gas program.

3.3.3 More importantly, as discussed in SEC's Final Argument, the specific legislative authority was required primarily to require such programs to be implemented. They are mandatory, not discretionary provisions. No party is arguing that the Board is required to enact a jurisdiction-wide model for natural gas, simply that it has the authority to do so if it so chooses, as was the case in *Advocacy-Centre*.

3.4 Policy Rationale Not Really Challenged

3.4.1 Parties who oppose a jurisdiction-wide subsidy model on policy grounds do so primarily on the basis that such a scheme has never been done before.[32] SEC accepts this would be a new principle and a departure from past practice. But if the Board is going to create a new framework which explicitly allows for subsidization of new expansions by existing customers, already a significant departure from the past, it should do so in a way that promotes, not harms, competition in the sale of gas, and protects consumers with respect to price. A jurisdiction-wide subsidy does that, where as an intra-utility model does the opposite.

3.5 Subsidy Is Not a Tax

3.5.1 The CPA argues that the creation of any cross-subsidy regime is an unconstitutional indirect tax.[33] Union half-heartedly endorses that view, although only insofar as it involves a jurisdiction-wide model, since they themselves are proposing an intra-utility cross-subsidy.[34]

3.5.2 The Board should reject these arguments. CPA misunderstands the purpose of rate regulation. At a fundamental level, it is the opposite of taxing. Unlike taxes, or other charges or fees levied by a government entity, absent the Board (through its authority under the *OEB Act)*, a natural gas utility could charge customers whatever it wants, and use that for whichever purposes it chooses. This is the not the case with taxes. Absent the legislative authority, the government could not require anyone to make any payment to it.

[32] See for example. Submission of the Building Owners and Managers Association, Greater Toronto ("BOMA") ["BOMA Submission"], p.3
[33] CPA Submission, para. 14-24
[34] Union Submission, para. 26

3.5.3 The Board's mandate is to control monopoly power in the setting of prices (i.e. rates), whereas with taxes, it is to levy a charge that would not otherwise be payable. There is no amount collected to be sent to government general revenues. All that is happening in a jurisdiction-wide subsidy model is that the total costs of natural gas system are being allocated differently amongst regulated utilities and ultimately their customers. This is a stark contrast to the Board's decision on a motion by the Consumers Council of Canada to challenge the *OEB Act* section 26 assessments, where it found that it did met the indices of a tax (although it was found to a valid regulatory charge).[35] In that case, the levy that was being required to be collected by electricity distributors from their customers were going to fund programs operated by the Minister of Energy that were outside of Board's authority and had nothing to do with those distributors' cost to serve but broader energy regulation.

3.5.4 Even if the Board agrees that rate-setting meets the criteria of a tax as set out by the CPA, it is still legally permissible. As Supreme Court has noted, almost all levies or charges will meet those criteria.[36]

3.5.5 The analysis does not end there.[37] It will still be permissible if the charge or levy is connected to a regulatory scheme, and is thus a valid regulatory charge. It will only be impermissible if it is "unconnected to any form of a regulatory scheme".[38] Rate-setting and community expansion are clearly connected to both, a narrow and broad regulatory scheme. The task is to determine whether the "dominant or most important characteristic is a tax", as opposed to its incidental features.[39]

3.5.6 The subsidy meets the two-step analysis set out by the Supreme Court[40], which itself is only intended to be a "useful guide" rather than exhaustive, and not all of the listed factors need to be present to find that something is a valid regulatory charge.[41] SEC

[35] *Decision and Order* (EB-2010-0184), December 8 2011, p.2-3
[36] *620 Connaught Ltd. v. Canada (Attorney General)*, 2008 SCC 7 ["*620 Connaught*"], para. 23
[37] *Ibid*
[38] *Westbank First Nation v. British Columbia Hydro and Power Authority*, [1999] 3 S.C.R. 134 ["*Westbank*"], para 43; *620 Connaught*, para. 23
[39] *Canadian Association of Broadcasters v. Canada*, [2009] 1 F.C.R. 3, para. 16
[40] *620 Connaught*, para. 25
[41] *Ibid*

submits a jurisdiction-wide cross-subsidy is part of a valid regulatory scheme (step 1)[42], and there is a nexus between the subsidy and the regulatory scheme (step 2). [43]

i) Valid Regulatory Scheme. SEC submits that rates that may, in part, go to a jurisdiction-wide subsidy, are part of the overall regulatory scheme for the regulation of natural gas distribution in Ontario. The Supreme Court has emphasized that a narrow approach to what the regulatory scheme is should not be adopted.[44] The regulatory scheme here is not just the expansion to unserved communities, but the entire interrelated set of detailed, complex code of regulation which includes legislation such as the *OEB Act*, *Municipal Franchise Act*, regulations made under them, codes, programs and policy regarding natural gas, and energy more broadly, including aspects that are outside of the purview of the Board.[45]

The regulatory purpose is to affect the behavior of utilities to expand natural gas distribution service in the province. Under the current rules, the utilities would not be able to expand to unserved communities. It is the purpose of this proceeding to determine if the Board should allow regulatory flexibility to allow them to do this.[46] This applies to both intra-utility subsidy and jurisdiction-wide subsidy. If the Board agrees that a subsidy of any kind is appropriate, then, as SEC has already argued, it would be furthering the objectives for natural gas regarding competition, protecting consumers with respect to price, and facilitating rational expansion.

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[42] *620 Connaught*, para. 25, citing *Westbank*, para. 44
1. a complete, complex and detailed code of regulation;
2. a regulatory purpose which seeks to affect some behavior;
3. the presence of actual or properly estimated costs of regulation;
4. a relationship between the person being regulated and the regulation, where the person being regulated either benefits from, or causes the need for, the regulation.

[43] *620 Connaught*, para 27:
"Provided that a relevant regulatory scheme is found to exist, the second step is to find a relationship between the charge and the scheme itself.
> This [relationship] will exist when the revenues are tied to the costs of the regulatory scheme, or where the charges themselves have a regulatory purpose, such as the regulation of certain behaviour."*(Westbank* , at para. 44)

[emphasis added]

[44] *Ontario Home Builders' Association v. York Region Board of Education*, [1996] 2 SCR 929 ["*Ontario Home Builders"*"], para. 86; *620 Connaught*, para. 15

[45] *Decision and Order* (EB-2010-0184), December 8 2011, p.14

[46] EB-2015-0179, Ex. A-1-Appendix, p.2, Letter from the Board, Re: Expansion of Natural Gas Distribution, Feb 18 2015

There will be a properly estimated cost of the required subsidy to meet the needs of the framework.[47] At this point it is premature to determine that, since no framework has been issued, or a subsidy model determined. But ultimately there will have to be an estimated cost, to determine how to set rates to collect the subsidy, whether it is intra-utility or jurisdiction-wide.

There is a relationship between the regulated (both utilities and their customers) and the specific regulation mechanism of the expansion framework.[48] The utility, who is in fact the party the Board regulates, benefits as they will be allowed to expand their natural gas system as they are seeking to do. They are also the cause of the need since under the current guidelines they claim without subsidies they are not able to expand natural gas to unserved communities. End use customers benefit, including existing customers, since a jurisdiction-wide mechanism promotes competition for expansion projects which has the effect of creating downward pressure on costs. This is a benefit to existing customers, as the expansion projects that are undertaken by their utility are more cost-effective, which reduces the risks they have taken on from lower than expected connections, and revenues are smaller and more equally shared among all customers.

ii) Nexus Between Subsidy and Scheme. There is clearly a relationship between the subsidy and the regulatory scheme as there is a "nexus" between the revenues raised and the costs of the framework.[49] The Board will set rates that will correspond to the subsidy. There is no reason that this would be any different than the normal rate-setting exercise, where the revenue raised is set to match the estimated costs. This is a bedrock principle of setting just and reasonable rates.

3.5.7 SEC submits that if the Board believes the subsidy meets the characteristics of a tax, it is still a valid exercise as it is properly characterised as a permissible regulatory charge and

[47] *Westbank*, para. 27; *620 Connaught*, para. 40-43; *Ontario Home Builders'*, para 55
[48] *Westbank*, para. 28
[49] *Westbank.* para. 44; *620 Connaught*, paras. 27, 38

not an indirect tax.

3.6 Other Ratemaking Options Should Be Considered

3.6.1 SEC cannot disagree with the blunt comments of Parkland that "[i]nstead of heeding the Board's request to canvas all options to expand natural gas service, allowing the Board to determine the preferred approach, Union and Enbridge simply advanced subsidy-based models designed to connect the maximum number of communities, with the majority of costs and all the risks borne by existing ratepayers".[50]

3.6.2 No other regulatory mechanisms were even considered by the utilities.[51] Both utilities take it as a given that to expand, the Board must provide for subsidies. Yet, they are taking no incremental risks[52] and will significantly benefit by the increase in their rate base. For the first time in its submissions, Enbridge recognizes there were other ratemaking options that could be employed, such as, reduced overhead allocations to project capital costs, extended attachment time horizons and reduced discount rates.[53] It is too late in the process for parties to adduce evidence regarding how effective they may be.

3.6.3 SEC agrees with the comments of Federation of Rental-Housing Providers of Ontario ("FPRO") | that the Board should consider the quid pro quo of relaxing the EBO 188 rules for the purpose of increasing the utilities' rate base. Any such change "should come at the long term risk of the utility not while providing existing ratepayers with some risk mitigation in exchange for a relaxing the safeguards included in the profitability standards."[54] While neither Union nor Enbridge considered taking a lower ROE to expand their combined rate base by over a half billion dollars,[55] EPCOR is considering it.[56] Since the utilities are not required to expand to unserved communities, there would not be a breach of the fair return standard if they are given a lower ROE for these investments since they will be undertaking them willingly and with notice.

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[50] Parkland Submission, para. 5
[51] S3.EGDI.SEC.1; EB-2015-0179 B.SEC.4; EB-2015-0179 , B.FRPO.1
[52] S3.EGDI.BOMA.13
[53] Enbridge Submission, para. 6
[54] FRPO First Round Submissions ["FRPO Submission], p.9
[55] Tr.1, p.227; S15.Union.BOMA.89
[56] S4.EPCOR.Board Staff.6

3.6.4 London Property Management Association ("LPMA") has proposed a number of recommendations the Board should consider making to Government. SEC agrees with them.

4 FRANCHISE AGREEMENTS AND COMPETITIVE PROCESS

4.1 Pre-Qualification.

4.1.1 Board Staff proposes that the Board could pre-qualify a pool of potential proponents who have the required financial, technical, and operational expertise.

4.1.2 SEC agrees that this would have the benefit of minimizing duplication of efforts on the part of municipalities and would help them in their evaluation. The problem is that the Board has no authority to undertake this process. The Board cannot simply initiate proceedings without some statutory basis to them.[57] Unlike in electricity, where this could be possible, the Board has no licensing authority for natural gas, so it is unclear on what grounds the Board could pre-qualify proponents.

4.1.3 As SEC has suggested[58], it would appear that the best thing the Board could do is provide information to unserved communities regarding which potential proponents could be interested in serving them, and their information.

4.2 Board Must Review the Process as it is the Protector of Ratepayers

4.2.1 Southern Bruce argues that the Board should not second guess decisions of municipalities in competitive processes, in a similar way to how the Board is not interested in the how and why that leads to specific MAAD transactions.[59] Further, they argue that confidentiality of the process should be maintained and the "Board should clearly signal that the confidentiality of the competitive procurement undertaken by municipalities prior to issuing franchise agreements will be preserved".[60]

4.2.2 SEC strongly disagrees with this approach. Unlike MAAD transactions where the test for

[57] *Northrop Grumman Overseas Corp. v. Canada (Attorney General)*, [2009] 3 S.C.R. 309, para. 44
[58] SEC Final Argument, para. 4.2.3
[59] Southern Bruce Submission, para. 123-125
[60] Southern Bruce Submission, para. 127

approval is if the transaction leads to "no harm"[61], that is not the same thing for either Franchise Agreement, leave to construct or Certificate of Public Convenience, nor ultimately for rate-setting. To determine if something is in the public interest, or in setting just and reasonable rates, the Board is required to assess the alternatives. If a different proponent could have been chosen at a lower overall cost, then the Certificate of Public Convenience (or leave to construct) should not be granted, as it would not be in the public interest. This is consistent with the Board's comments in EBO 125 where it said it must ensure that the Applicant is proposing the "least-cost alternative, having regard to relative cost, operational constraints, market access and environmental impact."[62]

4.2.3 SEC further disagrees with Southern Bruce that since they are democratically elected, municipalities *necessarily* are best positioned to represent the interest of local ratepayers.[63] As SEC has argued before, the interests of ratepayers and taxpayers are not totally aligned. Municipalities are elected to represent the interest of their municipal taxpayers. It is not to represent natural gas ratepayers. Southern Bruce is a perfect example of this difference in perspectives. Its proposed Franchise Agreement with EPCOR contains a franchise fee[64], something neither Enbridge nor Union have ever paid.[65] Such a transfer of funds may be in the best interest of municipal taxpayers, but not its ratepayers, especially considering EPCOR seeks to recover it from those ratepayers. Franchise fees are anti-competitive, and as Union rightly points out, they are impermissible under the *Municipal Act*.[66]

4.2.4 A provision like this is a significant benefit to the municipalities, but is detrimental to both the new Southern Bruce ratepayers, and existing ratepayers under a provincial cross-subsidy regime. This is because the selection of EPCOR was in part based on this proposal, and not completely on what was in the best interest of ratepayers of the proposed natural gas service, such as cost, rates, reliability, and experience. This franchise fee may be to the benefit of the municipality's taxpayers, but it is definitely not

[61] *Handbook to Electricity Distributor and Transmitter Consolidations*, January 19 2016, p.6
[62] *Report of the Board* (EBO 125), May 21 1986 ["*EBO 125*], para. 2.15
[63] Southern Bruce Submission, para. 102
[64] Tr.3, p.177
[65] S3.EGDI.SEC.25, S15.Union.SEC.10
[66] Union Submission, paras, 65-67; *Municipal Act*, 2001, S.O. 2001, c. 25, s.394(1)(e)

to the benefit of ratepayers. The Board has recently confirmed that the role of municipalities is not to represent the direct interest of ratepayers.[67]

4.2.5 Southern Bruce's argument and evidence in this proceeding shows that municipalities do not even recognize the difference. Mayor Eadie of Kincardine stated explicitly, when asked what perspective the Board should take when evaluating the sufficiency of a competitive process, that municipalities and ratepayers were "one and the same." In regards to the 1% payment from EPCOR, Mayor Eagleson of Arran-Elderslie did not see any difference between the benefits that flow to the taxpayer and that to the ratepayer:

> MR. RUBENSTEIN: ….
> And I want to understand, what's the benefit of ratepayers of having the successful proponent pay some form of money to the municipality? I understand the benefit to the municipality, but from the ratepayer's perspective.
> MAYOR EAGLESON: From the gas user's perspective?
> MR. RUBENSTEIN: Yes.
> MAYOR EAGLESON: Well, to me it's one and the same. They are a member of the municipality, that hopefully it will offset their taxes or keep their taxes from going up, so maybe it's out of a different pocket, but we're talking about the same person.

4.2.6 There is a difference, in fact, between ratepayers and taxpayers, and the Board is concerned only with the former. Its role is to protect consumers (i.e. ratepayers) with respect to price, reliability, and quality of service.[68] Its role is not with respect to taxpayers. The situation with Southern Bruce demonstrates that the interests of ratepayers are not the same as the municipalities in the competitive process.

4.2.7 Due to this, the Board must take a proactive approach in providing guidance to municipalities in regards to what criteria should and should not be considered in the selection of a successful proponent in a competitive process. A relevant selection criterion is not which proponent will pay the municipality the most amount of money. In setting those criteria, it is paramount that the municipalities consider what is in the best interest of ratepayers. If not, the Board will simply be forced to review the process in

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[67] *Decision on Appeal* (EB-2016-0050 - Hydro One Inc.) dated July 15, 2016, p.8:
> The OEB does not find that the Algoma Coalition primarily represents the direct interests of consumers (ratepayers) in relation to regulated services. That is not the role of a municipality or a group of municipalities.

[68] *OEB Act*, s.2(1)

much greater detail than would otherwise be required at a Franchise Agreement or Certificate of Public Convenience and Necessity hearing. The Board cannot approve a Franchise Agreement or issue a Certificate that is not in the interest of ratepayers.

4.2.8 Different process, selection criteria, and weighting will directly affect who will be selected.[69] The Board must scrutinize the process to ensure that it is being undertaken to choose the proponent whose proposal is in the best interest of the natural gas customers. It cannot implicitly delegate its authority to the municipality's competitive process.

4.2.9 The Board must also ensure that proper guidance is set out in any framework it may issue so that municipalities understand what the expectations are with respect to a competitive process.

4.3 Customer Consultations

4.3.1 Greenfield recommends that the Board require, in any competitive process, a specific requirement for major consumers to be consulted prior to granting a Franchise Agreement.[70] The Board should require the municipality to consult with all types of customers when it undertakes a competitive process, not just large users.

5 COSTS

5.1.1 SEC hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that SEC has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Original signed by

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Mark Rubenstein
Counsel for the School Energy Coalition

[69] Tr.7, p.44-45
[70] GreenField Specialty Alcohols Inc. Final Argument, para. 9

APPENDIX A

revenue requirement included in rates for the Project and the actual revenue requirement of the Project.

As detailed at Exhibit A, Tab 7, Schedule 1, the total capital cost of the Project is estimated to be $264.5 million, consisting of:

1) Construction of the Proposed Pipeline at a cost of $224.0 million; and,
2) Station modifications at a cost of $40.5 million.

Union is seeking approval of the recovery of the cost consequences of the Project as part of this proceeding because the Project meets the capital pass-through criteria as determined in Union's 2014-2018 Incentive Regulation Mechanism ("IRM") proceeding (EB-2013-0202). The intent of the capital pass-through mechanism is to capture the associated impacts of significant capital investments made in the IRM term that are considered "not-business-as-usual," as the capital expenditures cannot be managed in Union's Board-approved capital budget.

Union has recognized the urgent need for natural gas infrastructure reinforcement in Southwestern Ontario. Due to this increased demand for natural gas, Union has been working diligently on the Project for well over a year. Ontario's Cap and Trade program and the introduction of the Ontario government's 5-year (2016-2020) Climate Change Action Plan ("CCAP")[1] has resulted in significant risk to the return of any capital invested in natural gas infrastructure.

[1] Ontario government's Climate Change Action Plan ("CCAP") released June 8, 2016.

A key component of the overall Cap and Trade program is the investment of dollars collected through the price of carbon in order to reduce the province's GHG emissions. In Ontario, the CCAP details the government's direction and priorities for spending the Cap and Trade program proceeds, aimed at achieving its emission reduction targets. Prior to the official release of the CCAP, early reports indicated that "building code changes that would ensure all 'new homes and small buildings' built in 2030 or later do not use fossil fuels such as natural gas for heat or cooling; by 2050, this requirement would apply to all buildings." More recently, the government has now stated that it is not banning natural gas or forcing anyone off of it, however, the contents of the final CCAP appear to include putting restrictions on the use of natural gas in Ontario in the not too distant future (15 to 35 years). For example, at page 27 the CCAP states the government intends to update the building code as a means to support the action of setting lower-carbon standards for new buildings. Specifically, the government intends to update the code with "long-term energy efficiency targets for new net zero carbon emission small buildings that will come into effect by 2030 at the latest, and consult on initial changes that will be effective by 2020." Although the CCAP supports a renewable content requirement for natural gas and encourages the use of "cleaner, renewable natural gas in the industrial, transportation and buildings sector"[2], it promotes alternative energy sources to conventional natural gas use. The CCAP allocates almost $4 billion (nearly half of the entire plans' funding) in new grants, rebates and other subsidies directed toward energy retrofits and efficiency measures aimed at helping homeowners reduce their carbon footprints by supporting additional choice. In fact, as stated at page 27 of the CCAP, the government intends to help homeowners "purchase and install low-carbon energy technologies such as

[2] CCAP, section 6.1, p.28

geothermal heat pumps and air-source heat pumps, solar thermal and solar energy generation systems that reduce reliance on fossil fuels for space and water heating."

The overall objective, content and lack of detail within the CCAP have created a great deal of uncertainty for Ontario homeowners, businesses and institutions, and potential investors in Ontario including Union. This uncertainty creates the risk of recovery of needed investment and has caused Union to reevaluate the cost recovery term and depreciation of any new expansion assets.

The use of Board-approved depreciation rates for this infrastructure project results in a weighted average useful life of approximately 50 years. This depreciation expense would typically be used to calculate revenue requirements and resulting customer rate impacts.

The uncertainty created by Cap and Trade and the CCAP has driven the need for Union to calculate the revenue requirement and resulting rate impacts based on an estimated 20-year useful life of the Project assets rather than the weighted average useful life of approximately 50 years based on Board-approved depreciation rates. Depreciating the asset over a 20-year useful life better aligns the cost with the timing of the reported restrictions and potential elimination of natural gas heating in homes and businesses.

Union's choice of 20 years recognizes the changes being proposed by 2030 (when the CCAP indicates changes to the building code will be made for new small buildings "net carbon zero" targets) and is based on management's judgment. Depreciating the facilities over 20 years means that the full cost of

the investment is recovered by 2037. Although this will have a greater impact on customer delivery rates, Union is left with no reasonable alternative. Resulting sales service and direct purchase bill impacts of all Union in-franchise South rate classes with Panhandle System demands are provided at Table 3-1. The bill impacts of other Union South in-franchise, Union North in-franchise and ex-franchise rate classes are not significant. The calculation of all in-franchise bill impacts using a 20-year useful life and Board-approved depreciation rates is provided at Exhibit A, Tab 8, Schedule 6 and Exhibit A, Appendix B, Schedule 6, respectively.

Table 3-1
Bill Impacts of the Panhandle Replacement Project by Rate Class

Line No.	Particulars	20-Year Depreciation Sales Service (1) (a)	20-Year Depreciation Direct Purchase (b)	Board-Approved Depreciation Sales Service (1) (c)	Board-Approved Depreciation Direct Purchase (d)	Difference Sales Service (1) (e) = (a-c)	Difference Direct Purchase (f) = (b-d)
1	Rate M1	1%	2%	1%	2%	<0.5%	<1%
2	Rate M2	2%	6-8%	1%	4-6%	<1%	2%
3	Rate M4	4-6%	24-27%	3-4%	16-18%	1-2%	8-9%
4	Rate M7	2-5%	17-19%	1-3%	11-12%	1-2%	6-7%
5	Rate T1	2%	14-16%	1%	10-11%	<1%	4-5%
6	Rate T2	1%	18-20%	1%	13-15%	<0.5%	5%

Notes:
(1) Total sales service bill impacts assume Union's gas commodity and transportation rates per EB-2016-0040 (Union's April 2016 QRAM).

The total revenue requirement associated with the Project is approximately $5.0 million in 2017 increasing to $27.2 million in 2018. The revenue requirement represents the costs associated with the Project facilities deemed to be in service in 2017 and 2018. The revenue requirement is calculated based on Union’s proposal to depreciate the Project’s assets over 20 years rather than Board-approved

NPV of the cash inflows is equal to or greater than the NPV of the cash outflows, the PI is equal to or greater than one and the project is considered economic based on current approved rates.

If the project NPV is less than $0 or the PI is less than 1.0, a Stage 2 benefit/cost analysis may be undertaken in order to quantify benefits and costs accruing to Union's customers as a result of the project. The NPV of quantified benefits to customers resulting from the project is added to the project NPV from Stage 1 and then discounted at a social discount rate in order to calculate the direct net benefit of the project to Union's customers. The project is considered to be in the public interest if the net benefit is greater than $0.

The Stage 3 analysis considers other quantifiable benefits and costs related to the construction of the Project that are not included in the Stage 2 analysis, and other non-quantifiable public interest considerations.

Stage 1 – Project Specific Discounted Cash Flow (DCF) Analysis

Stage 1 economics were completed for the Project and results of the Stage 1 DCF analysis are shown at Exhibit A, Tab 7, Schedule 4. The results indicate a cumulative NPV of ($212) million and a PI of 0.19 over a DCF term of 20 years.

In light of the uncertainty created by Cap and Trade and the Climate Change Action Plan ("CCAP") (described in Exhibit A, Tab 3), the DCF has been completed on the basis of a 20-year term. For illustrative purposes the DCF based on the typical 40-year revenue expectation is provided at Exhibit A, Appendix A, Schedule 1.