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July 11, 2016

BY EMAIL & BY COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

Board File No. EB-2016-0004
Natural Gas Service – Community Expansion Proceeding
Energy Probe – Reply Submissions to the Board

Pursuant to Procedural Order No. 3, issued May 30, 2016, please find attached the Reply Submissions of Energy Probe Research Foundation (Energy Probe) in the EB-2016-004 proceeding.

Should you require further information, please contact us.

Yours truly,

David S. MacIntosh
Case Manager

cc. Andrew Mandyam, Enbridge Gas Distribution (By email)
Fred Cass, Aird & Berlis LLP (By email)
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Ontario Energy Board

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

AND IN THE MATTER OF a Generic Proceeding on Natural Gas Expansion in Communities that are not served.

**ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")**

REPLY ARGUMENT

July 11, 2016

Executive Summary

1. Energy Probe maintains its position, which it advanced in the first round of argument, that the Ontario Energy Board (OEB or the “Board”) should make no move to exempt, ease or scrap the current natural gas expansion guidelines laid out in EBO 188. As stated previously, the OEB’s mandate is to protect the interests of gas consumers, facilitate “rational” expansion of the gas distribution grid and maintain a “financially viable” gas industry. The existing guidelines have upheld that mandate -- as nearly every party to this proceeding has agreed, and Union admits in its Final Argument¹ -- admirably.
2. The success of the natural gas sector -- in that it has avoided the consistent double-digit rate increases seen in the province’s electricity sector -- is largely a result of the “economic” principles that have been put in place. Energy Probe sees no reason to explicitly move away from those principles.
3. The gas utilities have argued repeatedly throughout this hearing that the financial impact on existing customers is “reasonable”² and avoids “an undue burden”³. Yet, existing customers could see the Community Expansion programs add 6-7% to their monthly bill. Energy Probe questions whether that figure is “reasonable”, particularly as, according to figures presented by the utilities, Community Expansion customers will enjoy energy cost savings that could total as much as \$650 million, while also benefiting from a \$191 million transfer of wealth from existing customers in the form of cross subsidies. The larger concern for Energy Probe is that the utilities are asking for exemptions from regulatory principles that explicitly protect customers of a monopoly utility from being used to finance subsidy programs on the justification that the money at stake is “reasonable”. Energy Probe questions whether such a direction by the Board is in any way “reasonable.”
4. The predominant argument from the incumbent utilities has been that the social benefits -- both in the form of lower energy bills for new customers and the resulting province-wide economic activity they will create -- outweigh the drawbacks of moving away from strict, economic regulation. While those benefits are very much open to debate, they would certainly be better addressed through wider provincial policies implemented through the Ontario Legislature, not an economic regulator like the OEB.
5. Energy Probe will specifically address the argument presented by Board Staff and the two utilities, as well as highlight where our argument aligns with other parties participating in this proceeding -- though we don’t intend this to be an exhaustive list. We find that many parties are in agreement with our argument that the Board should refrain

¹ Union final argument, page 22

² Union final argument, page 13

³ Enbridge final argument, page 4

from moving away from the type of economic regulation that has supported a financially viable and customer-oriented gas sector in Ontario.

6. **Our Recommendation:** Energy Probe maintains that there is neither a regulatory nor a market failure in Ontario's gas sector. Economic regulation of the gas sector has served both ratepayers and gas companies well for nearly two decades. As such, we recommend that the Board not relax or provide exemptions to the EBO 188 guidelines. The province has tabled \$230 million of grants and loans to help expand the gas system. Both the Board and the gas utilities should work within the bounds of the financial opportunity offered by the province in expanding the gas sector to rural or remote communities.

Energy Probe's Response to Board Staff's Final Argument

7. Energy Probe agrees with Board Staff's assessment that any universal expansion fund "would be a significant administrative undertaking with additional financial costs." Board Staff rightly walks through the steps needed to establish such a fund -- a fund administrator would have to be set up and then be in charge of distributing that money to utilities and rate orders would have to be amended, for example. But we also believe that those costs may arise even if the Board were to allow the utilities to impose cross subsidies on their existing ratepayers -- which they argue are "administratively simpler" -- to support the Community Expansion projects. Cross subsidies may face similar regulatory headaches as a universal fund, since the money collected from existing customers would have to be examined separately in each rate proceeding. Those regulatory costs may be significant.
8. We see no reason why Board Staff has stuck with the 23 cents per cubic meter charge proposed by the utilities. According to the utilities, that charge will cost a typical residential ratepayer in Community Expansion projects around \$500 a year. But the benefit in lower energy costs is, on average, \$1,600 and \$1,700 for Union and Enbridge customers, respectively, each year.⁴ Even with the surcharge, new customers will, on average, shave around \$1,100 off of their energy bills annually. If the Board were to double that surcharge, for example, then the new customers would pay around \$1,000 in temporary surcharges, but would still see their annual energy costs decrease by about \$600 -- some customers, such as those that heat with electricity, would see thousands of dollars in savings annually. Raising the surcharge would make more projects economically viable. We hope the Board would reconsider the 23 cent surcharge in the proposals presented.
9. Neither Board Staff nor the utilities address the problem with the municipal tax increment financing proposal as it has been presented. While municipalities that are part of the

⁴ Board Staff final argument, page 17

Community Expansion Program will benefit in the form of lower energy bills and increased property values, some municipalities that are already connected to the gas system and will pay a premium for their gas, may see their property values decline. The tax increment financing program provides a benefit to some ratepayers (those in the Community Expansion Program) the expense of other towns and municipalities. The Community Expansion program would see the Board choose winners and losers. Energy Probe has repeatedly argued that the Community Expansion program distorts the entire provincial business and real estate market by artificially lowering the operating costs for municipalities in the Community Expansion Program.

10. Board Staff support the utilities' argument that new customers have, in recent years, subsidized existing customers and, as a result, existing customers today will benefit from the Community Expansion program. Energy Probe would like to highlight IGUA's excellent analysis that shows this is not the case.⁵ We also highlight VECC's response that concludes "there is no overall "benefit to existing consumers, since by definition these projects are net money losers."⁶ The current PI test ensures that expansion customers would cover the cost of that expansion over time at current rates. When rates are reset, all customers -- both existing and expansion -- benefit if there is a dilution of fixed costs. Under the Community Expansion program many expansion customers will never pay the total costs needed to finance that expansion. Any "benefits" that may arise will flow to the province as a whole. Even those benefits may be offset by negative impacts on rival energy suppliers and the increased costs to existing gas customers.
11. Energy Probe highlights that if the Board were to accept Staff's suggestion to lower in the individual project threshold PIs to 0.7, then it would also be supporting greater cross subsidies between expansion customers. While this may be more "reasonable" given the alternative of having all existing customers subsidize the Community Expansion program, it raises many of the same questions -- such as equity and other regulatory principles -- that the Board should carefully consider. As we have argued previously, the Community Expansion program is a subsidy to those businesses and residential customers in the new communities at the expense of existing customers. Cross subsidies among the utility's expansion portfolio sparks many of the same concerns, but focuses them among expansion customers.
12. We agree with Board Staff's proposal that any Leave to Construct for Community Expansion projects should provide separate costs for the transmission and distribution segment of the project, as well as any upstream reinforcement costs.⁷ We also agree with Board Staff's proposal that if reinforcement isn't needed, the money should be refunded to ratepayers.

⁵ IGUA final argument, page 4

⁶ VECC final argument, page 8

⁷ Board Staff final argument, page 25

13. Board Staff and many other parties in this proceeding continue to make very large assumptions in regards to the province's cap and trade program. Energy Probe has highlighted in other submissions to the Board that every single cap and trade program has, at some point, suffered from a significant crash both in prices and demand. There is every reason to believe that Ontario's cap and trade program will suffer a similar fate (California's carbon credit market, for example, has recently seen demand collapse). Furthermore, while cap and trade may well result in reduced gas demand, it may also increase it. For example, the province has highlighted natural gas trucks and transport as an alternative to diesel trucks. Furthermore, provincial policies that promote further electricity consumption -- transit and electrical vehicles, for example -- may result in either greater utilization of existing gas generating plants or the construction of new plants in the decades to come. Conversely, if electricity demand continues to fall or remain stagnant, the current and ongoing overbuilding of the province's electricity infrastructure will push hydro rates up beyond inflation for years to come -- making natural gas a competitive alternative for the long-term.
14. Board Staff rightfully highlights the conversion risk present in both utility Community Expansion applications.⁸ Energy Probe submits that nowhere in their application does either utility take on *any* risk as it relates to their Community Expansion applications. The risk that these projects turn out to be even more uneconomic than initially forecast lies solely with ratepayers. This is inappropriate. If risk were to be shared, we recommend that the area of conversion is one that the Board should consider. While the utilities -- as Board Staff suggest -- will present detailed "market research findings" we think the easiest way to ensure the utilities mitigate risk is to ensure that they assume some portion of it.
15. All money from the province's grant and loan program should be allocated to Contribution in Aid of Construction (CIAC) to improve the viability of Community Expansion projects. While Board Staff argues that loans from the province could be used to "support conversion costs", Energy Probe disagrees. No other gas customers receive subsidies for conversion (outside of CDM and DSM programs). If customers can't, or won't, cover the cost of conversion, the utilities can work with HVAC companies to come up with options for new customers. The utilities can also work with new customers in offering DSM money once they have signed on to connect.

Energy Probe's Response to Union's Final Argument

16. Union makes the case that the issue before the Board is not whether regulatory changes should be made in order to expand the natural gas system, "but rather *how* those changes are to be implemented."⁹ Energy Probe disagrees with this statement. In no single document that Union mentions does it say that the Board should relax its regulatory principles -- which were put in place to protect ratepayers from these types of

⁸ Board Staff final argument, page 35

⁹ Union final argument, page 2

policies -- to explicitly facilitate a cross subsidy program worth hundreds of millions of dollars. Furthermore, at no point in this proceeding did either utility put any of its own money on the table in order to help make that expansion possible. While Energy Probe is in no way advocating that the Board force the utilities to pay for social programs, we also don't believe that existing customers should either. We don't believe that it is a foregone conclusion that the Board has been told by government to authorize hundreds of millions of dollars worth of cross subsidies and the only matter up for discussion is how to implement that policy.

17. Union argues that the current regulatory regime (the "status quo") is "premised on the self-interest of competing fuel providers and does not advance the underlying policy objective, the interests of potential expansion area customers or municipalities, and does not recognize the broader benefits as demonstrated by the Stage 2 economic analysis."¹⁰ Union completely ignores the "no harm" principle that is embedded in the EBO 188 Guidelines. Furthermore, the utility ignores the fact that the EBO 188 guidelines also protect (economic) expansion customers from being used to finance future subsidy programs. In short, the current regulator principles serve the interests of past, present and future ratepayers and do not simply work in the favour of "competing fuel providers."
18. The current EBO 188 Guidelines also level the playing field among municipalities, as those towns and communities where businesses and homeowners pay a premium to have access to the gas system don't subsidize those businesses and homeowners that pay lower land costs to live in more rural or remote areas. Even without the Stage 2 analysis that Union mentions, the energy savings to expansion customers is worth \$650 million over the next 40 years, which is significantly more than the province-wide benefits. That suggests there is an informational barrier, not a market failure.
19. Union cites a Supreme Court case¹¹, which concludes that consumers should be "overall...paying no more than what is necessary for the service they receive." To Energy Probe -- which admittedly did not get legal counsel and so is reading this from the perspective of economists -- that statement goes completely against Union's Community Expansion proposal, which will charge existing ratepayers for services they won't receive or benefit from.
20. Furthermore, Union never acknowledges that its proposal -- as well as Enbridge's -- is inherently discriminatory in that it ensures that only customers of those two utilities have to cover the cost of a social program that will benefit the province as a whole.
21. Union argues that its "intra-utility subsidization" proposal is allowed under the current regulatory policies, but then admits that those guidelines ensure that the "principles of

¹⁰ Union final argument, page 4

¹¹ Union final argument, page 8

cost causation are, to the extent possible, adhered to.”¹² The entire Community Expansion program explicitly moves away from the principle of cost causation. Both utilities have repeatedly argued that the social benefits of the Community Expansion applications would be of net benefit to the province and that the rate impacts for existing customers would be “reasonable.” Even if the Board were to take both of those statements as true -- although many parties throughout this proceeding presented compelling evidence to the contrary -- they still don’t align with the principle of cost causality.

22. Union’s own figures show just how uneconomic many of its Community Expansion projects are -- providing more evidence for why the Board should not approve the application or seriously curtail it. For example, more than 50% of the customers served in the Community Expansion portfolio are in communities where the profitability index (PI) is between 0.4 and 0.5.¹³ That means that more than half of all the Community Expansion customers would only recover 40% to 50% of their total costs -- with the remainder largely being picked up by existing customers.
23. Ultimately, even Union admits that the EBO 188 guidelines have “served the industry and most ratepayers well.”¹⁴ The only reason the utility presents for changing it is the “recent provincial policy goal” of bringing gas to unserved communities. Energy Probe is in agreement that the EBO 188 guidelines have served ratepayers well and it’s provincial policy that has instigated this hearing, but we don’t believe that cross subsidies are a foregone conclusion. The province has tabled \$230 million to help achieve its goal of gas expansion; we see no reason why the utilities or the Board must add to that figure.

Energy Probe’s Response to Enbridge’s Final Argument

24. Enbridge argues that “the cost of service of a gas distributor does not include the costs of funding the expansion of service by another distributor”¹⁵ and that the Board has “no jurisdiction” to create a universal fund that would see customers of one distributor subsidize those of another distributor. While Energy Probe agrees that the Board should refrain from creating a universal fund, Enbridge doesn’t address the discrimination embedded in its proposal. As we have argued previously, if the benefits of the Community Expansion program are province wide, there’s no reason why only customers of particular gas distributors should be the only ones to have to pay for it.
25. Enbridge argues against a universal fund, saying that it ignores “many of the fundamental tenets of rate making for regulated utilities.”¹⁶ Enbridge’s proposal -- and Union’s -- also ignore many of the fundamental principles of ratemaking that are

¹² Union final argument, page 12

¹³ Union final argument, page 16

¹⁴ Union final argument, page 22

¹⁵ Enbridge final argument, page 3

¹⁶ Enbridge final argument, page 3

embedded in the EBO 188 Guidelines. In the Supreme Court case mentioned by Union - and also used in Energy Probe's final argument -- it is clear that one of the fundamental principles of ratemaking ensures that customers are "overall...paying no more than what is necessary for the service they receive." Energy Probe believes the proposals of Union and Enbridge -- as well as the universal fund proposed by EPCOR -- move the Board away from the core principles that have created a successful and financially viable gas industry in Ontario.

26. Finally, we would like to draw attention to Enbridge's figures in point 38¹⁷ that show, even with an exorbitant carbon price, natural gas remains a competitive alternative to other fuels.

27. Also, we think it's necessary to highlight Enbridge's well-reasoned argument that "in comparison to electricity using gas for space and water heating purposes is far more efficient than burning gas to generate electricity to be used for space and hot water heating."¹⁸

Other Positions that Align with Energy Probe

28. IGUA

- a. "Supporting gas distribution expansion through permanent subsidies from existing customers is not an appropriate regulatory tool."¹⁹
- b. "An economic regulator has no legitimate role in determining or directing the transfer of wealth from one set of regulated service customers to another. To the extent socially desirable, to facilitate economic development in the community or otherwise subsidize energy services to particularly vulnerable communities, wealth transfers from one group of Ontarians to another is a role for government."²⁰
- c. "Where a gas distribution system expansion is uneconomic (that is, savings to expansion customers do not exceed expansion costs), forcing existing customers to subsidize the expansion is not only unfair to existing customers, it is wasteful from a societal perspective."²¹

29. From BOMA

¹⁷ Enbridge final argument, page 11.

¹⁸ Enbridge final argument, page 12

¹⁹ IGUA final argument, page 2

²⁰ IGUA final argument, page 2

²¹ IGUA final argument, page 3

- a. "These proposals create a "utility within a utility", the purpose of which is to pursue uneconomic expansion projects. These projects are inconsistent with [the] legal basis of just and reasonable rates, which is that utilities' rates be cost-related. These projects and the portfolios of such projects they constitute are outside the zone of economic reasonableness..."

22

- b. "In BOMA's view, no rationale has been advanced for a proposal which would result in so many uneconomic projects being pursued. The utilities' proposals ask the Board to go well beyond demonstrating "flexibility". They want to do away with EBO-188 altogether. For this reason, and the reasons which follow, the Board should reject them."²³

30. From Parkland

- a. "Subsidization by existing customers would violate the fundamental rate-setting principle of cost causality, since existing customers would receive no benefits from the expansion projects proposed."²⁴
- b. "From a regulatory economics perspective, allowing incumbent utilities to roll-in the capital cost of uneconomic expansions is economically inefficient."²⁵

31. From VECC

- a. "The Board is charged with setting just and reasonable rates. As noted above, currently subsidies from existing ratepayers are allowed as "reasonable" if they don't impose an undue burden. However, we do not think the Board should now adopt exemptions to EBO 188 simply based on the conclusion that the costs are diminutive. It is all too easy to "nickel and dime" captured customers of regulated monopoly utilities. Ontario's electricity customers have been subject to a plethora of social policy initiatives and programs that individually have minimal impact, but taken together turn out to have a material rate impact. These increases are particularly difficult for low-income customers."²⁶
- b. "The Board should not proceed until the Government has announced how it intends to allocate the announced resources. If the Board is being responsive to a government objective to bring natural gas service to unserved communities, then it seems realistic that expansion takes place on a case by case basis in accordance with the recommendations herein."²⁷

²² BOMA final argument, page 38

²³ BOMA final argument, page 12

²⁴ Parkland final argument, page 2

²⁵ Parkland final argument, page 2

²⁶ VECC final argument, page 26

²⁷ VECC final argument, page 38

32. From CPA

- a. “Both LDCs suggested that the proposed framework represents a “balance”. However, a framework where one group pays and the other group benefits is a straight win-lose, not a balance. The fact that the increased cost to the first group is “reasonable” does not make this a balanced proposal, as there is still one group that pays but does not benefit, and another group that receives a benefit for which it did not pay.”²⁸

Conclusion

33. All across the province, both businesses and homeowners have made investment decisions based on the economic principles embedded in the EBO 188 guidelines. Changing those guidelines will have a domino effect across the province, both on gas customers and the economy in general. We recommend that the Board refrain from moving in that direction. Furthermore, these principles have ensured that existing customers pay no more for gas than the cost to service them. Energy Probe believes that continues to be the most equitable – and financially viable -- way to manage the gas sector.

Costs

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Energy Probe has participated responsibly in all aspects of the process.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

July 11, 2016

²⁸ CPA final argument, page 7