EB-2016-0004

ONTARIO ENERGY BOARD

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.

REPLY SUBMISSIONS OF UNION GAS LIMITED

July 11, 2016

These are the reply submissions of Union Gas Limited ("Union") in this proceeding.

A. Introduction

1. In its initial submission in this proceeding, Union identified factual parameters that the Ontario Energy Board (the "Board") must take into account in its consideration of the EBO 188 guidelines and any new regulatory constructs that it might establish in the context of the expansion of a natural gas services to unserved communities including First Nation communities. These factual parameters are:

- there is a clear and present need for expanded natural gas services to Ontario communities as shown by the request of unserved communities;
- based on this need, the Long-Term Energy Plan ("LTEP")[1], the Minister of Energy's letter dated February 17, 2015[2] and the letter from the Board dated February 18, 2015[3], the fundamental question is not about whether regulatory changes should be implemented to facilitate the expansion of natural gas services but rather how those changes are to be implemented;
- key considerations for the Board include:
    - o the mechanism by which a subsidy is to be provided since expansion cannot purposefully be provided without some form of cross-subsidization;

[1] Ministry of Energy, *Achieving Balance – Ontario's Long-Term Energy Plan* (December 2, 2013) ("LTEP").

[2] Letter from the Minister of Energy to Ontario Energy Board Chair (February 17, 2015) ("Minister's Letter")

[3] Letter from the Ontario Energy Board re: *Expansion of Natural Gas Distribution* (February 18, 2015) ("Board's Letter").

- o in establishing the cross-subsidization, the appropriate balance between the interests of new and existing ratepayers must be established; and
- o the practical application of the regulatory approach must be considered to ensure that the complexity of the regulatory regime matches the timing and magnitude of need.

2. On the whole, the choice before the Board is whether it chooses to facilitate the meaningful expansion of natural gas services to unserved communities or to permit minimal expansion, if any, though minor changes to EBO 188 policies that are akin to the status quo.

3. In this proceeding, three primary approaches have been presented. First, exemptions to EBO 188, which in some cases would permit an internal utility subsidy that contemplates a sharing of costs by one utility's existing and new ratepayers, and in others, minor amendments to EBO 188 that provide little or no subsidy and correspondingly minimal expansion. Union's proposal is the former, providing for a fair and reasonable balance between Union's new and existing customers with a model that provides a subsidy within clear and transparent parameters to enable expansion to 29 communities with an impact on existing customers of only $2.91 per year. Alternatively, other parties (such as Board staff and consumer focused intervenors such as School Energy Coalition ("SEC") and London Property Management Association ("LPMA")) have proposed minimal amendments intended to protect existing ratepayers by eliminating or minimizing the subsidy. This results in the expansion of service to very few communities.

4. Second, led by EPCOR, a new model is proposed based on competition and a global subsidy scheme that is flawed since it is beyond the Board's jurisdiction and in any event, will require multiple regulatory processes and proceedings to establish the regime.

5. Third, parties such as of the Canadian Propane Association ("CPA") and Parkland Fuel Corporation ("Parkland"), for their own commercial self-interest, deny the need for community expansion of natural gas services notwithstanding that these fuel providers benefit indirectly from municipal and provincial services which subsidizes the sale of propane relative to natural gas and leaves unserved communities economically captive to higher priced and higher carbon content fuels (see section E(b) below for further discussion on this point). Consumer focused intervenors such as Consumers Council of Canada and Energy Probe are opposed to any cross-subsidization and thereby community expansion outside of the current EBO 188 guidelines.

6. The context in which the Board now considers community expansion and the EBO 188 guidelines cannot be ignored. Union's own 29 community expansion projects would provide natural gas system access to only 18,000 new ratepayers, which is 1.2% of Union's current customers and 0.5% of the ratepayers across the province. Given the balanced nature of Union's approach it is unlikely that more communities would be eligible for service without significant aid from a source other than the proposed cross subsidy. In effect, through its proposed approach, Union is attempting to serve the last 1% of Ontario's customers without government funding.

7. In this context, Union submits that the Board should choose to facilitate "meaningful" expansion of natural gas services to these unserved communities by moving away from the status quo and adopting the internal utility subsidy approach as proposed by Union that facilitates expansion, has little rate impact and uses a known and transparent rate process that permits efficient and timely implementation. As explained in section C below, the Board does not have the legal authority to permit subsidization on an inter-utility basis. Even if it did, the Board should avoid the regulatory and process complexity of creating an entirely new regime as proposed by EPCOR, which cannot occur without extensive consultation and proceedings by the Board to resolve issues of implementation and the transparent development of program parameters that go well beyond the current generic proceeding[4]. In this regard, taking into account the limited scope of eligible community expansion and efficiency of implementation, London Economics International LLC. ("LEI") indicated that Union's utility cross-subsidy approach is the most favourable after assessing four alternative funding approaches (including jurisdiction-wide cross subsidization as proposed by EPCOR).[5]

8. LEI's general conclusion expressed in oral testimony was that:

> "in circumstances where community expansion was a small proportion of the overall rate base, the principles of administrative simplicity tended to outweigh the principle of strict cost causation such that the overall benefit of internal utility cross-subsidization was greater than other mechanisms, due to administrative simplicity."[6]

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[4] Transcript Vol. 4, page 119; Union initial submissions, page 28.

[5] Union, EB-2016-0004, Exhibit A, Tab 1, Schedule 1, pages 13-14.

[6] Transcript Vol. 2, page 7.

9. The submissions that follow will deal with (i) the internal utility subsidy model and Union's response to assertions opposing that approach; (ii) consideration of the Board's jurisdiction; (iii) issues relating to competition; and (iv) other considerations for the Board.

B. Internal Utility Subsidy Model

10. Union's community expansion proposal is comprised of three key elements:

(i) allowing for supplemental revenues through (a) a temporary surcharge payable by customers served by Community Expansion Projects, and (b) a mechanism for municipalities to contribute toward the feasibility of Community Expansion Projects;

(ii) applying lower minimum economic feasibility thresholds through (a) an exemption from the minimum project PI threshold established in EBO 188 for Community Expansion Projects, and (b) an exemption from the requirement established in EBO 188 for Community Expansion Projects to be included in both the distribution Investment Portfolio and the Rolling Project Portfolio ("RPP"), which exemptions collectively result in a small subsidy from existing customers to new customers; and

(iii) deferral accounts to assist in administering the process, including (a) a deferral account to capture the temporary customer surcharges and municipal contributions, which would then be disposed of to ratepayers to reduce cross-subsidization, and (b) a deferral account to capture variances between the forecast net revenue requirement approved in rates and actual net revenue requirement for Community Expansion Projects, which would then be disposed of to ratepayers in proportion to the allocation of project costs to rate classes.

11. Various intervenors have put forward arguments as to why Union's internal utility subsidy approach is not appropriate. However, the arguments made by those intervenors are flawed and should not be accepted by the Board since they present (i) an overly narrow interpretation of rational expansion that is contrary to the current policy imperative underlying this proceeding, and (ii) an incorrect interpretation and understanding of the components of Union's internal subsidy approach. Further, any argument that an internal subsidy approach is not relevant ignores the fact that new customers have been subsidizing the costs of existing customers for years, as evidenced by Union's 3 year average annual RPP results of $14.6 million

in positive net present value per year[7], which would be equivalent to $44 million over only 3 years, or $146 million over 10 years.

(a) Rational Expansion

12. Although Board staff and some intervenors, purportedly representing consumer interest (such as LPMA and SEC), have expressed support for the expansion of natural gas service to unserved communities, this support, however, is in reality muted and tacitly provided since one of the fundamental tenets of their positions is that there be little or no subsidy provided by current ratepayers in favour of new ratepayers. In effect, support for expansion to unserved communities is only given if the status quo is mostly preserved. This is clearly reflected in SEC's and LPMA's restrictive interpretation of "rational expansion".

13. LPMA defines economic expansion as any group of projects that does not result in any adverse long term rate impacts on existing customers. According to LPMA, this means that the RPP has a profitability index of 1.0 or greater. LPMA takes the view that the Union and Enbridge proposals are neither rational nor economic since they contemplate RPP profitability indices below 1.0 and have existing customers subsidizing new customers.[8]

14. SEC holds a similar view that "[a]t a fundamental level, uneconomic expansion is not rational expansion."[9] According to SEC, any changes to the guidelines made by the Board must lead to expansions that are economic. SEC believes that this is the intent of the Minister as set out in his letter to the Board when making reference to rational expansion of natural gas service.[10] Interestingly, despite SEC's narrow economic construct of rational expansion, elsewhere in its submission SEC supports a certain level of subsidization on an inter-utility basis to facilitate community expansion.[11]

15. Like LPMA and SEC, some parties take the position that the words "rational expansion" found in the Board's statutory objective "to facilitate rational expansion of transmission and

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[7] Union's updated application in EB-2015-0179, Exhibit A, Tab 1, Table 4 at page 32.
[8] LPMA submissions, page 3.
[9] SEC submissions, page 3.
[10] SEC submissions, page 3.
[11] SEC submissions, page 27.

distribution system" means only economic expansion.[12] This, however, is an overly narrow interpretation and ignores the plain meaning of the phrase. There is no express reference to economics. While economic factors are part of the considerations that underlie "rational expansion", they cannot be the exclusive determination. "Rational" means to have some reasonable basis or plan that is not arbitrary. Given the Board's broad public interest mandate and the plain meaning of its objective, the Board has the latitude to consider other aspects in addition to economics including the expressed need by communities, the LTEP and the Minister's letter.

16. The positions of SEC and LPMA are based on a false premise. If expansion was to occur on a basis as suggested by them, then expansion to the communities in question would have already occurred and there would be little need for this proceeding. The fact that the current EBO 188 regime does not permit a subsidy and that further expansion is curtailed as a result, is the motivation and intent underlying the Minister's letter and the Board's response initiating this proceeding. In the Board's letter dated February 18, 2015 inviting applications for the expansion of natural gas services, the Board stated "[t]o the extent that the economics of a proposed project may not be accommodated within the current regulatory construct, the Board invites proponents to identify, within their applications, any options to address such regulatory issues."[13]

17. This is consistent with the LTEP which states:

> "Ontario wants to make sure communities have access to natural gas to take advantage of the changing North American market and low prices. Natural gas heating is significantly less expensive than that provided by electricity or heating oil. There is also increasing interest in the use of compressed or liquid natural gas as a transportation fuel for corporate car and truck fleets, to reduce costs and the emissions of greenhouse gases.
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> The quality of life and economic prosperity of Ontario depends on having secure access to competitively priced natural gas and an equally competitively priced natural gas transmission and distribution system."[14]

[12] CCC submissions, page 16; Energy Probe submissions, page 3.

[13] Board's Letter, page 2.

[14] LTEP, page 75.

18. It is in the context of this policy imperative that proposals for the rational expansion of natural gas services must be considered and not within the strict and narrow construct proposed by intervenors such as SEC and LPMA, which in effect seek to maintain the guidelines of EBO 188. As such, Union has undertaken a principled approach to gas service expansion. This principled approach is consistent with the following:

- Customers and municipalities who directly benefit from Community Expansion Projects should contribute to the financial viability of the project;
- Expansion customer contributions to project feasibility should be commensurate with the savings achieved by switching to natural gas;
- Moderate cross-subsidization from existing customers is acceptable, provided long term rate impacts are reasonable.

19. The internal utility subsidy approach proposed by Union strikes a reasonable balance between the interests of current and future ratepayers, with minimal rate impacts derived in a transparent manner through an open process.

(b) Allocation of Risk Benefit and Cost

20. Certain intervenors took the position that Union did not assume sufficient risk in respect of its proposal to provide expanded natural gas services. In particular, LPMA indicated that Union's request for two deferral accounts as part of its proposal sheltered Union from risks that it otherwise should bear.[15]

21. Union has requested a community expansion project variance account. This account would be established for the purpose of recording variances between the forecast net revenue requirement approved in rates and actual revenue requirement for all community expansion projects. Balances in these accounts would be disposed of to ratepayers in proportion to the allocation of community expansion project cost to rate classes. According to LPMA, this account reduces Union's risk associated with that revenue requirement. LPMA takes this position on the basis that under cost of service regulation, Union is at risk for any variance between forecast and actual net revenue requirement.[16] Union is typically at risk for the variance between forecast and

[15] LPMA submissions, pages 9 -11.
[16] LPMA submissions, page 9.

actual net revenue requirement only until the next cost of service proceeding. Furthermore, this risk is born in the ordinary course of regulation and operation of the utility. However for Union, the current circumstance of community expansion is not in the ordinary course. The expansion projects undertaken require an expansion surcharge that is volumetric in nature.[17] As a result, Union faces the added risk of the pace of conversion over time and the recovery of a volumetric charge. This is not a risk that Union typically assumes in the context of cost of service regulation. As such, the requested deferral account is appropriate. Further, Union has adopted a conservative approach to forecasted attachments to mitigate attachment forecast risk.[18]

22. Union has requested a second deferral account which LPMA asserts also minimizes Union's risk of community expansion. Union is seeking a community expansion contribution for the purpose of recording TES contributions from customers and ITE contributions from Municipalities. The purpose of this deferral account is to allocate the TES and ITE revenues to ratepayers to reduce the cross subsidization of capital costs. This account is for the benefit of rate payers and will only accumulate a positive balance to defray costs to subsidize. Therefore, this second deferral account does not operate to minimize Union's risk.

23. Intervenors representing primarily consumer interests assert that the benefits to new customers of converting to natural gas are excessive relative to the costs incurred by existing customers through the payment of a subsidy. However, the difference between the benefits received and the costs incurred is only at a level sufficient to provide for meaningful expansion of natural gas service. This will enable new customers to enjoy the benefit of natural gas relative to other fuels that existing customers have enjoyed over a long period at a relatively low rate impact for existing customers.

24. Under Union's proposal, net of the TES and ITE deferral account credits, the expected peak rate impact for existing customers of Union's proposal, comprised of 29 projects to serve 33 new communities, would be $2.91 per year or $0.24 per month for a typical residential

[17] A volumetric surcharge instead of a fixed monthly surcharge is necessary for the purposes of maximizing revenue and limiting the risk of connections becoming seasonal in nature (e.g. a customer may choose not to connect water heaters so the gas meter can be shut off for parts of the year).

[18] EB-2015-0179, Exhibit B.South Bruce.6 (c).

customer.[19] Some intervenors have suggested that the Board should ignore this fact and focus only on the distribution rate increase and not take the overall impact into account. This, however, is being selective. The Board's objective in this proceeding is to establish a basis of expansion of natural gas service. As such, it should consider the total cost consequence of Union's proposal and not just one aspect. Intervenors have also asserted that the Board should not be swayed by "nickel and dimes" impacts since they can mount over time.[20] However, this is also not a valid argument since the number of projects eligible for expansion is finite as is shown by the economics of the 29 projects proposed by Union. There are very few, if any, additional projects that can be added because of project economics under Union's proposal. The expected costs are what they are and, as noted above, the overall impact is minimal.

(c) Capital Pass Through

25. Also under the Union proposal, Union is proposing a capital pass-through mechanism to recover the Community Expansion Project capital costs when these expansion projects come into service. These investments are considered "not business-as-usual" and thus cannot be managed within Union's Board-approved capital budget through Union's 2014-2018 Incentive Regulation Mechanism ("IRM"). Some intervenors take exception to Union's position that its capital pass through request is not prohibited by the IRM framework. According to SEC, the IRM framework is all encompassing and it is not open for a utility to ask for amounts to be passed to ratepayers.[21] Union notes that the current capital pass through exists within the IRM framework. Although, the current request for a capital pass through is supplemental to that capital pass through mechanism, it is sought for comparable reasons. To the extent that that mechanism exists within the IRM framework, Union's current request would not be inconsistent with that approach. Furthermore, notwithstanding the IRM framework, applicants are not pre-empted from seeking relief in respect to circumstances that are outside of the ordinary course and not contemplated within the existing rate order.[22] In addition, if the required capital investment cannot be recovered until the next cost of service application, this would represent a barrier to existing utilities in terms of

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[19] Transcript Vol. 4, page 172.

[20] VECC submissions, page 26.

[21] SEC submissions, page 49.

[22] Transcript Vol. 6, pages, 151, 234.

their ability to compete for Community Expansion Projects relative to new entrants, who would not face such a barrier.

(d) Economic Feasibility

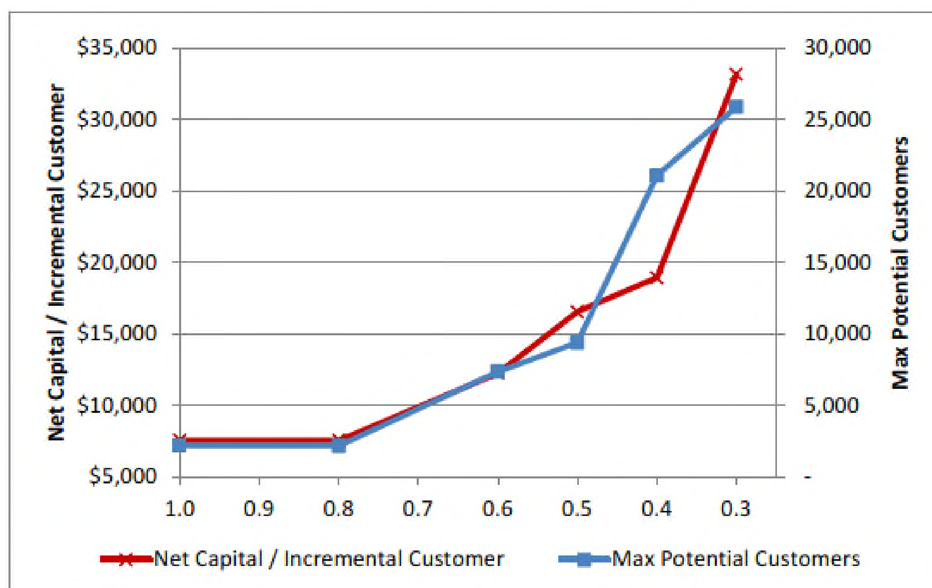
26. Union has proposed that the economic threshold for community expansion projects be reduced to a PI of 0.4. Reducing the project PI to 0.4 allows Union to achieve a balance of furthering the provincial goal of providing customers in non-serviced communities the ability to gain access to the natural gas, while being mindful of potential rate impacts for existing ratepayers.

27. BOMA, CCC, EP and LPMA all argue that the PI threshold should remain at 0.8 as set out in the EBO 188 guidelines. OEB staff takes the position that the Board should only lower the individual project PI from 0.8 to 0.7. SEC takes the position that the Board should not accept Union's proposed PI threshold because it is not based on an objective external standard. At the same time, SEC provided no indication regarding the type of objective external standard, if any, that underlined its proposed PI threshold of 0.6.

28. In establishing the PI threshold, Union completed an analysis of potential projects compared to the potential customers and capital spending represented at various maximum PI levels. Results of this analysis are set out in the figure below.[23]

[23] Union's application in EB-2015-0179, Exhibit A, Tab 1, page 25.

Community Expansion Projects Enabled at Various PI Levels



29. As indicated in the figure above, the amount of capital on average required to provide access to each incremental customer increases at a consistent rate with the decrease in the threshold PI from 0.8 to 0.4. A decrease in the threshold to a PI below 0.4, however, results in increases in average capital costs at a higher rate than the addition of customers. As a result, Union believes that it has struck an appropriate balance between the number of incremental customers provided access relative to the average capital costs that would require financial support either through an expansion surcharge or subsidy from existing customers.

30. The consequence of leaving the PI threshold at 0.8 (or even 0.7 as proposed by Board staff) is that very few unserved communities will obtain the benefit of natural gas services. The analysis above includes the required term for the TES and ITE to make each project feasible at a minimum PI of 0.4 and the amount of contributions-in-aid-of-construction ("CIAC") required for the project to reach that PI threshold after including the TES and ITE for up to 10 years. Based on these assumptions, even a reduction of the minimum PI to 0.6 would result in reducing the number of projects to 14 from 29 projects as proposed by Union and providing service to only 15 communities down from 33 as originally proposed.[24]

[24] Union's application in EB-2015-0179, Exhibit A, Tab 1, Table 3 at page 26 (Note: The number of new communities that may be served under Union's proposal has been revised from 34 to 33).

31. The consequence of increasing the minimum PI is either a longer term over which the TES is payable by new customers or a higher TES rate. Most intervenors that represent consumer interests maintain that the term should extend up to 40 years. A term of this length creates significant forecast risk relative to the term of up to 10 years as proposed by Union. A forecast of this length is highly uncertain and is of questionable reliability given the number of unknown factors that could materialize over a 40 year period. It would not be reasonable to establish rates on the basis of a circumstance which is a highly uncertain. Furthermore, a 40 year commitment from new customers is a disincentive to conversion further affecting the economics of expansion, and would serve as a long term impediment to ability to attract new businesses in expansion communities. A 40-year surcharge period would in essence amount to higher rates for some communities than other neighbouring communities (who currently have natural gas service) for the long term. The difference in rates would remain a barrier to growth for the communities affected for a significantly extended time period, albeit this would be less of a barrier than the alternative of not having access to natural gas is today.[25]

32. This type of approach (adopting a 40 year period) would represent a departure from Union's preference to continue to apply postage stamp ratemaking principles wherever possible. Given Union's proposals which include a deferral credit to ratepayers for the amount of surcharge revenue collected, the tracking and reporting period could be extended dramatically with significant extension of the Surcharge period.[26] In this regard, Union's proposed TES term of 4-10 years presents a practical and sensible approach that would be more readily acceptable to potential customers.

(e) Treatment of TES/ITE

33. LPMA submitted and others endorse a position that the TES/ITE should be treated as an "aid" to construct and be credited to rate base. However, contrary to this position, customers are better off when the proceeds from the TES/ITE are treated as revenue.

34. At pages 12 and 13 of its submissions, LPMA presents two graphs created by LPMA, which are apparently drawn from attachments to Union's interrogatory response Exhibit B.

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[25] FRPO submissions, page 8.

[26] Ibid.

LPMA.1 (EB-2015-0179). However, LPMA's analysis is flawed, misrepresenting both the data and results presented by Union in the interrogatory response. The graph purports to compare the revenue requirement of the TES/ITE as aid as compared to TEST/ITE as revenue. It is flawed because their data only uses the TES/ITE collections in the "aid" case and reflects a comparison to zero TES/ITE collections in the "revenue" case.

35. Making reference to line 11 of attachments 2 and 3, LPMA erroneously uses "gross revenue requirement" which is the figure before collection of any revenue of any kind from any customer. They erroneously assert that this is the figure that will be "paid by all customers". The assertion is wrong. Rates will be the net of gross revenue requirement less "normal" revenue from new customers less the impact of the TES/ITE (treated as revenue as proposed by Union and treated as an aid as proposed by LPMA).

36. However, because gross revenue requirement is used, the data used for the graph excludes revenue of every kind. It is a comparison of "Gross Revenue Requirement without TES/ITE and without normal revenue " as compared to "Gross Revenue Requirement if a TES/ITE is collected and treated as an aid" and without normal revenue. The former simply has zero TES/ITE revenue included in any manner. As one would expect, if you compare (although done erroneously) two cases, each with zero revenue and one case with a smaller investment because of an aid to reduce the investment, the aid case will have a lower revenue requirement. The graphs provided by Union in Exhibit B.LPMA.1 are a true comparison of including the same TES/ITE in revenue and as aid. As noted in Union's response in LPMA.1, customers are better off for some 23 years when treated as revenue.

37. Because of the foregoing, the LPMA statement below is incorrect.

> *"The sum of the total revenue requirement over the forty years, which can be derived from the attachments noted, 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 under the Union proposal."*[27]

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[27] LPMA submissions, page 12.

38. In fact, properly including the TES/ITE in both cases (as revenue and as aid) is shown in LPMA.1 Attachment 1, line 12 which shows the cumulative difference year by year. After 40 years the difference is $236,000 in favour of "aid". The $236,000 is in relation to the capital spend of $4.9 million, which is less than a 5% difference.

39. LPMA also states:

> *"If this is even close to being true, the use of the TES payments as offsets to capital rather than as revenue will reduce the net present value of the costs to be recovered from ratepayers by close to 25%."*[28]

40. Because LPMA's figure is wrong, the result of about 5% (calculated as $236,000 divided by $4.9 million) after 40 years is more factual. It is purely a mathematical result, whereby the inclusion in revenue caused rates to be reduced to a greater extent than if TES/ITE were treated as aid. For example, assuming the TES is approximately $500 annually, when recognized as revenue it reduces the project revenue requirement by $500 – a 1 for 1 relationship. When $500 is credited to rate base as an aid, it will reduce the annual revenue requirement by the pre-tax amount of approximately $35. Put simply, as an aid the annual revenue requirement is reduced by 7% as compared to 100% in the case of revenue.[29]

41. From an accounting perspective, treating the TES as revenue would be consistent with generally accepted accounting principles. This was explained in Union's interrogatory response in EB-2015-0179, Exhibit B.LPMA.1 b), as partly excerpted below:

> *"A contribution in Aid-to-Construction ("CIAC") is an amount collected and recorded at the time of construction. The proposed Temporary Expansion Surcharge ("TES") is a rate for service charged to customers in new communities as service is provided. Amounts earned as a result of providing service are accounted for as revenue consistent with generally accepted accounting principles ("GAAP"). The recovery of amounts from the municipality while not based directly on service provided are proposed to be recovered over time and will also be recorded as revenue. Treating some portion of the recovery of*

[28] LPMA submissions, page 13.

[29] The pre-tax revenue requirement for the return, taxes and depreciation is about 7% of the capital amount because the CCA tax shield offsets the depreciation expense for early years.

incremental costs as revenue and other amounts as a reduction in plant is unnecessarily complicated."

42. Moreover, if TES/ITE were treated as aid, there would be the additional complexity that for each and every year for the life span of the TES (i.e. 40 years under LPMA's proposal versus 10 years under Union's) the rate base associated with the project would need to be adjusted to account for the credit arising from the TES/ITE.[30]

C. Jurisdiction

43. In this portion of the submission, Union responds to comments made by certain parties, most notably EPCOR, VECC and Board Staff, with respect to the Board's jurisdiction to permit subsidization on an inter-utility basis. For the reasons set out in its initial submission and below, it is Union's position that the Board has no such jurisdiction.

44. There is no decision, by a court or the Board, in which an inter-utility subsidy of the form proposed by EPCOR has been held to be within the Board's jurisdiction. As set out below, the authorities referred to by EPCOR and others are distinguishable and undermine their position.

45. EPCOR begins its argument by observing that the Board's rate-setting jurisdiction has been interpreted "broadly", that the definition of "rate" is itself broad and that the Board may elect any "method or technique" that it considers appropriate in fixing rates. None of these observations is controversial. But none leads to the conclusion that the Board has the jurisdiction to impose an inter-utility subsidy on ratepayers.

46. For example, in highlighting the broad definition of rate, EPCOR cites the Board as holding that, "it [rate] appears to cover virtually any payment from a customer to a utility <u>for the provision of distribution service</u>" (emphasis added). On a plain reading, "rate" as defined by the Board therefore refers to a payment by a customer to its distributor for services provided by that distributor, not, as EPCOR would have it, a payment for services provided by another distributor to different customers located in a different community. This plain reading of rate is entirely

[30] EB-2015-0179, Exhibit B.LPMA.1.

consistent with the "regulatory compact" as recently articulated by the Supreme Court of Canada, as discussed further below.

47. The first case discussed by EPCOR is the Divisional Court's decision in *Advocacy Centre for Tenants – Ontario v. Ontario Energy Board*[31]. EPCOR's position in relation to that case is unclear. EPCOR begins by stating that "the case is highly relevant to the jurisdictional question currently before the Board".[32] Several pages later, however, EPCOR attempts to downplay the case suggesting that it has been "superseded by the clear finding of the Supreme Court in *OPG*".[33]

48. *Advocacy Centre* does not support EPCOR's position. As the Divisional Court held in that case, "the traditional approach of 'cost of service' is the root principle underlying the determination of rates by the Board because that is necessary to meet the fundamental, core objective of balancing the interests of all consumers in the natural monopoly utility and rate/price setting."[34] It is fundamentally inconsistent with this root principle for customers of one utility to pay for the cost of a service they do not receive, and which is provided by a different utility.

49. The Supreme Court of Canada's decision in *Ontario Energy Board v. Ontario Power Generation Inc.*[35] also does not support the jurisdiction to establish an inter-utility subsidy. At issue in *OPG* was the reasonableness of OPG's compensation costs and whether those had to be assessed using a no-hindsight prudence review. The Court held that they did not. Subsidization was not in issue. Nevertheless, the Court did comment on the regulatory compact which underpins the concept of "just and reasonable" rates. At paragraph 20, Justice Rothstein, writing for the majority, explained the compact as follows:

> In order to ensure that the balance between utilities and consumers interest is struck, <u>just and reasonable rates must be those that ensure consumers are paying what the Board expects to cost to efficiently provide the services they receive</u>, taking account of both operating and capital costs. That way, consumers may be assured that, overall, <u>they are paying no more than what is necessary for the</u>

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[31] (2008), 293 D.L.R. (4th) 684 ("*Advocacy Centre*").

[32] EPCOR submissions, page 8.

[33] EPCOR submissions, page 15.

[34] *Advocacy Centre*, para. 52.

[35] [2015] 3 S.C.R. 147 ("*OPG*").

> service they receive, and utilities may be assured of an opportunity to earn a fair return for providing those services. (Emphasis added.)

50. As in the Board's discussion of the meaning of "rate" the Court articulated the regulatory compact by reference to payment for services received by customers (consumers) from the utility. By definition, an inter-utility subsidy violates this articulation of the regulatory compact. EPCOR's submission that the Supreme Court approached the regulatory compact "holistically", in terms of services received by consumers on the one hand and utilities provisions of those services on the other – without distinction based on the existence of a direct contractual relationship between a "utility and a consumer", flies in the face of the above passage. There is simply no support for EPCOR's submission that "consumers should pay for all the services they receive, irrespective of the identity of the utility whose endeavours provide them."[36] A better articulation of the issue raised by EPCOR is whether customers should be required to pay for benefits they do not receive, and which are provide by a different utility. The answer to that question is no.

51. EPCOR also refers to the Board's decision in Union's 2013 cost of service proceeding (EB-2011-0210). Unfortunately, in describing the case EPCOR misstates the facts and draws the wrong conclusions. Contrary to the implication in EPCOR's submission, the case did not concern ratepayers paying for services located elsewhere on Union's network which were not directly related to the cost of serving them. Rather, at issue was the proper method for allocating costs associated with Union's Parkway Station. As Union had noted, in defending the allocation to its in-franchise customers, they received a benefit from being connected to Parkway because without it, the customers could not access Dawn Storage. In the result, the Board agreed with Union and upheld the allocation of Parkway Station costs to in-franchise customers. This finding is entirely consistent with the general principle of benefits follow costs referred to at paragraph 23 of Union's initial submission.

[36] EPCOR submissions, page 13.

52. For its part, VECC relies mainly on the Supreme Court of Canada's decision in *Bell Canada v. Bell Aliant*[37]. While the case assists Union and those parties which support some form of limited intra-utility subsidy, it does not assist VECC.

53. The main issue in *Bell Canada* concerned the disposition of certain deferral accounts by various telecommunications providers and whether this amounted to retroactive ratemaking. The Court held that it did not. A secondary issue was whether some of the funds in the accounts could be directed to the expansion of broadband service by the providers to their customers located in rural and remote areas. This was controversial because the funds had been collected at first instance from local telephone subscribers. In the result, the Court upheld the CRTC's decision to use some of the funds to expand rural and remote broadband service. In other words, the Court upheld an *intra*, but not an *inter*-utility subsidy.

54. Much of Board staff's argument supports the conclusion that the Board lacks jurisdiction to establish a province-wide inter-utility fund. Union agrees with this position. For example, it is Union's position that the express grant of power in s. 79 of the OEB Act leads to the conclusion that such a power does not exist in s. 36 of the *Ontario Energy Board Act*.[38] Union disagrees, however, with Board staff's reliance on the Uniform Transmission Rates ("UTR"). First, in the case of the UTR the revenue requirement for each of the transmitters is set separately. Second, given the interconnected nature of the electricity grid, all customers benefit from transmission services. It is appropriate that they pay for this benefit. This is unlike EPCOR's proposal. Enbridge customers for example would receive no benefit from service provided by EPCOR to its customers and they should not be required to pay for it.

D. Competition and Barriers to Entry

55. In the context of the Board's consideration of policies to facilitate community expansion, EPCOR, as its primary proponent, proposes competition for municipal franchises. The proposal is presented in the abstract; EPCOR makes a variety of assertions regarding the benefits of competition (e.g. lower cost, accelerated time frames, shared services etc.).[39] However, each of

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[37] [2009] 2 SCR 764 ("*Bell Canada*").
[38] See Union initial submissions, page 7.
[39] EPCOR submissions, page 29.

those aspects is based upon jurisdictional examples that are different from Ontario's circumstances and the robustness of competition in those circumstances. Other than the communities of South Bruce, it is clear from the sizes of the communities identified by Enbridge and Union as part of potential communities that are eligible, the communities are small and not necessarily contiguous as in South Bruce. There is no evidence before the Board as to whether these remaining communities will have the wherewithal to conduct a competitive process or that the scale of the distribution opportunity would in fact generate sufficient interest to provide for the benefits EPCOR espouses. What EPCOR is asking the Board to do is to formalize a competitive process with no empirical evidence as to whether benefits would ensue or whether any party (both the municipality or supplier) would be interested to the extent required to provide for robust competition.

56. In any event, there is nothing prohibiting a community from embarking on a process similar to the one South Bruce conducted without the Board creating a formal process.

57. EPCOR highlights the East West Tie project as an example of competition that would apply to municipal franchises. It has no application. That project was a discrete project of a significant size with a capital commitment well in excess of the Union and Enbridge community expansion portfolios combined. There is no comparison to a circumstance where an opportunity could include as few as 50 customers. EPCOR's scheme is bigger than reality.

58. In the context of its submissions on competition, EPCOR raises the issues of barriers to entry.[40] EPCOR asserts that advancement charges are a barrier to entry. Union's reply to this aspect is set out below. EPCOR also highlights that the demonstrated need for experience as a natural gas distributor to obtain a franchise approval and CPCN is a barrier to entry and relies on two cases for the fact that no experience is required to have existing local gas distribution facilities[41], which Union submits equates to experience. The two cases are Greenfield Energy Centre and Greenfield South Power. Both dealt with electricity generators that self served their natural gas need through a bypass pipeline. Local distribution services to serve the general public were not the basis of the CPCN and were not considered by the Board. As such, the cases cannot

[40] EPCOR submissions, page 36.
[41] EPCOR submissions, page 38.

be relied on as proposed by EPCOR. EPCOR's position in this regard underlines a critical fact which it is trying to avoid, which is that EPCOR does not and has not carried on business as a natural gas distributor and undertaken all the critical aspects that that responsibility requires.

59. EPCOR also highlights the requirement to have rates at the time of franchise approval as a barrier. This notion seems incongruous with EPCOR's ardent view on competition. Without some sense of the rates to be applied, how would the Board know whether the least cost provider will provide the service as opposed to a provider that has been awarded the franchise for other reasons relevant to the municipality and not ratepayers? Waiting until the leave to construct as suggested by EPCOR would mean that no other cost comparator is available[42].

E. Other Considerations

(a) Advancement Charges

60. Union has proposed that where adequate capacity is available in the upstream distribution system for a new connection, but future expected upstream distribution reinforcement timing will be accelerated to allow for other routine connections to the system, an advancement charge would be included in the Discounted Cash Flow analysis of a project to recognize the need for planned future capital reinforcement investment earlier than would otherwise be expected. EPCOR takes the position that charges for advancement of reinforcement costs are barriers to entry as the charge is not based on actual cost. However, Union's proposal is fair and reasonable since the development of a major reinforcement can extend over a number of years and it would be unfair to tie up all existing capacity for the benefit of the customer triggering the reinforcement to the exclusion of other customers that may want to connect and would be subject to expansion costs that would otherwise not be incurred but for the reinforcement project. Board staff is in broad agreement with Union's proposal and agrees that if a specific project causes or brings forward additional reinforcement of an upstream pipeline system, the project should be responsible for the reinforcement costs.[43] Union's proposal is also fully supported by LPMA.[44]

(b) Alternate Fuels

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[42] Union initial submissions, pages 24-27.
[43] Staff submissions, page 26.
[44] LPMA submissions, page 21.

61. CPA has asserted that propane suppliers would be treated unfairly in the event the Board provided for changes to EBO 188 and facilitated the expansion of natural gas service to unserved communities. However, in doing so, CPA has ignored a fundamental economic difference between propane delivery and that of natural gas. For natural gas delivery, the customer pays (in addition to the commodity cost) the whole cost (both capital and variable) of delivery – the entire pathway from pipeline interconnection to the front door. This is not the case for propane delivery. Many of the costs associated with propane delivery reflect costs that are socialized over all Ontario taxpayers. For example, a propane company may pay for the trucks that carry the fuel, but the road system used is paid for by all tax payers. This is opposite to natural gas where the full cost of all aspects of the pipeline is paid for by the customer. As such, CPA's members receive an indirect subsidy that has enabled propane to enjoy a competitive advantage relative to natural gas in the rural and remote areas of the province. The implication of a Board decision to adopt Union's proposal would be the leveling of the playing field and not as asserted by fuel providers a tilting of the playing field. The adoption of CPA's position by the Board would result in rural and remote customers remaining economically hostage to fuel choices that are less environmentally friendly and economically advantaged by indirect subsidies.

62. The OGA has asserted that geothermal is cheaper than natural gas expansion. Evidence provided by OGA is misleading in that the costs have been "cherry-picked", using worst case costs for gas and best case costs for geothermal. For example, for geothermal, OGA has assumed a 30,000 British Thermal Unit per Hour ("BTUH") heating load in order to keep the geothermal loop costs confined to a single vertical loop. The only homes that could be heated with equipment of that size would be the newest super insulated homes being built today; existing buildings built even 10 years ago would typically have a need for 45,000-80,000 BTUH furnaces, which would increase the geothermal loop costs.[45] For natural gas, OGA continues to overstate the required natural gas consumption for a home using a 60,000 BTUH furnace, further overstates natural gas costs by including both the total capital costs for the expanded natural gas system and the monthly gas bills that are in part a means of paying for a portion of that capital cost[46], and assumes new central air conditioning systems will be installed with every new natural

[45] Exhibit S11.OGA.EGD.5 (h) and (i).
[46] Exhibit S11.OGA.UGL.3 (i).

gas conversion[47]. Union considered the cost of geothermal/solar heating and water heating equipment and concluded that the up-front cost of these systems, estimated at $26,000 to $30,000, would be prohibitive.[48]

63. Further, the Canadian GeoExchange Coalition, in a comment letter to the Board in this proceeding on March 31, 2016, voiced its support for natural gas community expansion and noted that the current market conditions are not favourable to the mass deployment of geothermal heating for the residential sector:

> *"We are generally of the view that the current proposal to extend the natural gas pipeline to rural communities in Ontario is a positive step towards improving Ontario's carbon footprint. Natural gas use goes way beyond heating buildings and homes. It is an important economic development tool and a significant step towards helping these communities – including First Nations' Communities – to access a cheaper and cleaner source of energy and help local businesses, institutions, farms and other potential gas users to improve their competitiveness. Every community in Ontario deserves an equal access and an equal opportunity for lower energy supply options.*
>
> *The current relative electricity rates and natural prices in Ontario are not favorable to the mass deployment of ground source heat pumps in the residential sector as showed in Appendix 1. Since 2009 – and net of distribution charges – electricity rates have been rising constantly and natural gas prices declining constantly. This is a market reality…"*[49]

F. Conclusion

64. As noted, the choice before the Board is whether it chooses to facilitate the meaningful expansion of natural gas services to unserved communities or to permit minimal, if any, expansion. Union's proposal provides the Board with the ability to facilitate meaningful community expansion through an efficient and transparent process relative to the expansion opportunity, consistent with the Board's objectives and the public interest as reflected in the LTEP.

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[47] Exhibit S11.OGA.UGL.3 (h).

[48] As provided in EB-2015-0179 at Exhibit B.LPMA.2 c).

[49] Canadian GeoExchange Coalition's letter to the Board, March 31, 2016, pages 1-2.

All of which is respectfully submitted this 11th day of July, 2016.

UNION GAS LIMITED
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