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April 27, 2017

VIA E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319, 2300 Yonge St.
Toronto, ON¸M4P 1E4

Dear Ms. Walli:

Re: EB-2016-0137/138/139 Applications Elderslie, Kincardine and Township of Huron-Kinloss: Submissions on Draft Issues List and Draft Filing Requirements

In response to Procedural Order No. 5, VECC provides the following submissions.

THRESHOLD ISSUES

Principles of EB-2016-004

In our submission, the principles in EB-2016-0004 should guide the process for this application. We have attempted to extract the salient principles from the decision. This is not an exhaustive list; we have not articulated, for example, those matters with respect to the role of liquefied natural gas or the details of non-exclusive certificate granting. For clarity we have made a selective extract of those principles that we think are relevant in this proceeding. We have shortened some of the extracted passages, but to the extent possible used the language of the decision. The principles that we submit should apply are set out as follow:

a) The OEB does not consider it appropriate or necessary to subsidize projects that result in sufficient savings to customers to cover the costs of the projects. What is required is a method of overcoming the upfront investment hurdle.

b) The guidelines in E.B.O. 188 function less effectively when applied to expansions to discrete new areas that are not contiguous to the existing distribution system. Altering the thresholds within the existing guidelines and obtaining direct funding from existing customers to accommodate the shortfall in revenues would not be required if the expanded system had stand-alone rates intended to cover the cost of the expansion.

   There is no need to modify the parameters or depart from the principles embodied in E.B.O. 188 to facilitate expansion projects.

   No changes are required to the existing Model Franchise Agreement.

c) The OEB agrees with the establishment of stand-alone rates.

d) The OEB agrees that information regarding proposed rates and resulting rate impacts are critical to evaluate any expansion proposal.

e) The initial rates required to finance the expansion would be part of the economic test information required for the leave to construct required for the expansion.

f) Rate stability introduces a discipline that significantly reduces the need to scrutinize a proponent's projected revenues. The proponent will also have to obtain approval to adjust rates beyond the rate stability period. A minimum rate stability period of 10 years (for example) would ensure that rates applied for are representative of the actual underpinning long-term costs. The utility would bear the risk for that 10-year period if the customers they forecast did not attach to the system.

g) Other sources of funds from government sponsored programs or municipal contributions can continue to be used as capital contributions as they are now, or used directly to offset homeowner conversion costs. The OEB will be considering the ultimate costs to be borne by ratepayers in its comparative assessments of multiple proposals.

h) The cost of upstream enhancements that any project would bear must be the same regardless of the utility proposing the expansion. This will allow for proper comparison of competing bids, again levelling the playing field.

i) Contiguous expansion of the existing system with development on the edge of serviced areas would continue to be managed under the E.B.O. 188 framework. Demarcation criterion will be needed to separate those projects that would appropriately be dealt with in that manner rather than applying for new rates.

In the remainder of this submission we have followed the format and responded to the submissions of Board Staff.

1. Keeping in mind the principles set out in the Decision with Reasons for the generic community expansion proceeding (EB-2016-0004), what should the process for selecting a proponent look like when there are competing proposals for serving a community?

We have reviewed Board Staff's submission with respect to an appropriate process for this proceeding. VECC has no objection to clear filing dates and meeting of deadlines. However, it is unclear to us why Board staff believes there is urgency for the South Bruce proposed expansion. The area in question has been the subject of exploration of service for a number of years. There are no pending customers who do not have energy options. VECC is not suggesting delay, but we are suggesting that there is no need to seek unnecessary expedition at the expense of due process, or invent a new process for these applications.

Decision Criteria

We are unable to discern what decision criteria Board Staff believe are embedded in the Draft Filing. In our view, the guidelines should articulate the nature of the evidence to be filed. Procedural Order No. 2 in EB-2016-0004 provides the only guidance for the Board, which VECC notes that Board members are not bound by. Ultimately it seems to us the Board will need to answer three questions:

1. Is the Applicant qualified to operate a natural gas distribution service in the affected franchises?
2. Can the Applicant provide safe and reliable gas supply for the term of the franchise?
3. Is the successful proposal the most economically beneficial to the ratepayers of the affected franchise?

Customer Meetings

While customer input is important, VECC is uncertain as to the value of holding a community meeting that may amount to little more than a face-off between two opposing utilities. Such a venue risks turning the event into a political debate, given that each applicant has an opportunity to build political support, such as by offering non-related incentives in the form of community support, or one applicant may enjoy more local popularity for reasons that do not relate back to the Board' mandate or should not inform the Board's decision. Factors that form the basis of the Board's mandate and should inform its decision include: the public interest as considered by economic evaluation, reliability of service, and operational safety.

In our view, a community presentation, or other types of community meetings, should be held if and when the Board has made such determinations that require an understanding of the potential customers and their needs and views. An example of such a situation would be if one applicant might propose to raise project deficiencies through a contribution from the local municipality, while the other might propose higher rates. Both applicants are purposing to address a "profitability gap" in the project, but customers may have different views on which is a preferable way to address that deficiency.

If the Board believes that urgency exists in considering these proposals, we would caution that community meetings with undefined objectives will neither serve the record nor the timelines.

Written or Oral Process

VECC does not object to a (partially) written process. In fact, for much of the review, a written process may very well suffice. However, it seems to us premature to make the decision at this juncture. Once the record develops, and if, as we suggest below, the hearing is bifurcated into logical steps, then an oral proceeding, especially in the latter stage of the process, might serve to quicken the outcome.

In our submission, the Board's process should anticipate a number of items:

- whether the application is in regards to contiguous or non-contiguous service areas;
- the qualification of the Applicants to hold a franchise or be granted a certificate;
- the valuation of any upstream cost; and
- comparison of the Applicants' service proposals.

As articulated in the Board's decision, whether the application is with respect to contiguous or non-contiguous service areas has a bearing on the evidence required to be filed. As such, it is a threshold issue that needs to be decided prior to evidence filing.

The initial qualification of the Applicant to hold a Franchise and a Certificate, is also a threshold issue as there would be little reason to go through the time and expense of such a proceeding if the parties do not have the *prima facie* ability to undertake service.

In our submission, qualification to hold a franchise and certificate could be shown by evidence of financial capacity, technical skills in the area of natural gas provision, and demonstration of being of good character so as to reasonably be seen as having the business character to provide natural gas service. Sections 2 and 3 of the draft filing guidelines list the type of information the Board might require to make a decision on eligibility.

While the Board grants such agreements, the views of the affected municipalities are clearly important. It would, for example, be difficult for the Board to grant a franchise were the local government resistant to having that business operate in their municipality. At a minimum, the Board would need to understand any such objections prior to granting these rights.

In our view, the Board should render a decision on qualification to hold the Franchise and Certificate prior to proceeding to an actual review of the proposal to serve. Otherwise, those involved would unnecessarily expend significant costs to develop proposals and hold a prolonged proceeding.

This process need not be cumbersome. Incumbent utilities, unless mitigating circumstances exist, are qualified by the fact of their existing Ontario natural gas businesses. Specifically, Union Gas Limited and Enbridge Gas Distribution would both be considered qualified on the basis of their carrying out this business for the vast majority of gas consumers in Ontario. The franchises in question would entail a *de minimis* part of their business. EPCOR Southern Bruce Gas Inc. (EPCOR-Southern Bruce) has no such history in the province and must provide sufficient evidence as to its qualifications.[1]

Board Staff Proposal Regarding Interrogatories

Board Staff suggests that interrogatories should be issued only by the OEB to both proponents. We are unclear if by this staff means it intends to take over the role of intervenors or if it is suggesting the panel of the Board will be vetting the interrogatories of the parties. In any event, both are objectionable.

In our view, Board Staff does not have the ability or the legitimacy to fulfil the role of "super intervenor", regardless of whether the role is simply coordinating interrogatories or vetting them for purported appropriateness. If the panel of the Board were themselves to take on this role, then the objectivity of the entire proceeding is called into question. The panel would change from a hearer of facts to a party pursuing issues. We question whether the panel of the Board should be put in the position of altering parties' questions. If objections arise to a particular instance of altering or exclusion of a question, is the same Board panel to decide on the outcome?

It also appears to us that staff is suggesting that there must be a commonality of questions to the applicants. If so, we think this unlikely. Two proposals, no matter how much effort is made for uniformity, will inevitability attract different questions from the Applicants. Moreover, they *should* attract different questions, if the underlying facts and contexts of the applications differ from each other.

Board Staff's proposal is objectionable as matter of fairness and transparency. It leaves open the potential for appeal from aggrieved parties. If staff believes that urgency is of the essence, then this

[1] As would Union Gas or EGD should they incorporate separately to apply for a new franchise?

suggestion threatens to indefinitely prolong the proceeding. In any event, Staff have made no compelling arguments in favour of such a drastic change for these applications, to the process that the Board has used successfully for the past 30 years.

Technical Conference

In a number of places, VECC has suggested a conference with the objective of creating commonality among the applications. We believe this is likely to significantly shorten the time of the proceeding, as even identical filing requirements are likely to lead to different forms of that evidence. If so, the issue of comparability may cause significant difficulty in this process.

2. Should the funding of this process be treated as a business development cost or a regulatory expense, recoverable from future ratepayers? What other approaches should the OEB consider?

We assume that "this process" refers to the application proceeding as a whole. In an application where two parties compete for service, at least one (and maybe both) applicants may not succeed. In the absence of a pre-approved deferral account, for the incumbent utility, this cost is absorbed into whatever regulatory costs are "baked into rate". For the unsuccessful greenfield applicant, there is no ability to recover costs since there are no regulated rates available to recover them in. Both parties therefore enter the proposal with some risk.[2]

In our view, fairness dictates that either the costs of both (all) applicants be included in the recovery of future ratepayers, or neither party is allowed to recover these costs. Allowing both parties to recover these costs is likely to be costly and sets a precedent that might encourage less robust or serious applications.

Another alternative would be to allow a set amount of "business development costs", that both parties are allowed to recover. In order to not overly complicate this and to ensure that varying business development costs do not influence the competing proposals, the Board might use a pre-determined cost recovery amount. It might, for example, use a percentage of the average capital cost of both proposals as an amount to be recovered in a regulatory fee adder. It would, of course, be open to the applicants to waive such costs in order to improve the attractiveness of their proposal.

3. How should a rate stability period be implemented for the South Bruce areas? Is a 10-year rate stability period too long or too short? Should proponents have the opportunity to update costs during the rate stability period? If so, what types of costs?

In our view, deciding on the duration of the rate stability period is fact-specific. The economic viability of the project, the alternative energy sources, and the conversation rates of customers would all inform such a decision.

In this regard we would suggest that the Board's decision denotes a difference between "rate stability" and "fixed rates." It does not seem reasonable that rates would be fixed for any prolonged period. Fixed or "frozen" rates are rare and, other than by government fiat, have only been approved when the Board

[2] Depending on timing it is possible for the incumbent utility to mitigate this risk by adjusting its regulatory cost forecast.

is of the view that underlying cost pressure are declining, such as in a merger or utility acquisition. If this were not the case the rate impact after a prolonged rate freeze might be severe.

In our submission, the Board articulated a principle that is somewhat mischaracterized as "rate stability." Reading the section in its entirety, one might more accurately describe the principle as one of "customer forecast stability":

> *Competing utility companies would be incented to provide rates favourable to customers in order to be selected as the preferred proponent of the expansion project. The selected proponent would then be incented to maintain low rates in order to be attractive to potential customers which would in turn should increase its margins. A minimum rate stability period of 10 years (for example) would ensure that rates applied for are representative of the actual underpinning long-term costs. The utility would bear the risk for that 10-year period if the customers they forecast did not attach to the system. At present, once an expansion is approved, the utility bears little long-term risk if its forecasts were overly optimistic, or its actual costs higher than expected. The cost is absorbed into rates and paid for by other ratepayers.* [i](EB-2016-0004 Decision with Reasons, pg. 20)

Since a proposal for rate stability can presumably incorporate anticipated inflationary and other cost pressure, it would be our view that the applicant must provide a "rate plan" for their proposal. It is not necessary, in our view, that there be a common rate plan rather than allowing applicants to propose different rate plans.

The principle in EB-2016-0004 is that the customer attachment risk during a defined period is borne by the successful proponent. Provided both proponents adhere to the same attachment risk period, there is equal treatment of their respective economic evaluations. That is, if both applicants are required to carry out a cost-benefit analysis over the same time horizon (e.g. 25 years) and also required to absorb any revenue shortfall due to lower-than-forecasted attachments during that same period, then their respective rate plans to recover the forecast revenue requirements can be compared. Applicants can use different attachment forecasts. However, an overly optimistic forecast (perhaps hoping to show a superior proposal) would be at a higher risk than a more conservative one.

It also appears to us that the Board needs to consider the "stability" of the estimated capital cost and the inevitable variance from those costs no matter which Applicant is successful. Otherwise it would be simple to underestimate service costs in order to gain the franchise. Therefore, it may be that both the customer forecast and the capital that is recoverable in rates needs to be fixed at the outset. Again, if it is fixed for the period of the cost-benefit analysis then the risk of over- or under-earning lies with the successful applicant.

Because a greenfield operation will have an immediate large rate base with only a small amount of depreciation, the initial revenue requirement may not be indicative of a sustainable rate. Therefore, the applicant needs to propose a rate plan for a given period. This might include an initial cost of service period followed by periods of rate escalation to capture deferred costs and inflationary pressures. Ideally, the plan would be in sections (akin to the 4-5 year IRM period commonly used in gas and electricity) so as to allow periodic review and oversight by the Board.

After the initial rate plan, the utility might be allowed to rebase under cost of service, depending on particular circumstances to be determined. However, the customer attachment forecast would remain as forecasted in the initial application. Such a scheme encourages utilities to present realistic attachment forecasts in their initial applications, as an overly high forecast would risk unrealized earnings, while too low a forecast would risk showing a net present value of the project lower than the competing franchise proposal. We also think the Board's principle important because it leaves to the utility to find ways to encourage attachments, and therefore builds in an incentive to maximize customer attachments.

4. Is there a need for a common format for applications to be able to appropriately assess and compare the value propositions of different proponents – for example through establishing filing requirements?

• If so, please provide comments on the draft filing requirements attached at Schedule C.

• Should the OEB use a Reference Plan based on a set of working assumptions such as long term system demand? What other parameters should be set in a Reference Plan?

In a number of places, Board Staff have used the term "Reference Plan". This concept is not, to our knowledge, defined in any way in their submission or discussed in the Board's prior decision. As such, we are unable to comment on the merits of using such a plan.

We can, however, give the Board the benefit of our experience in the Markdale/Flesherton/Dundalk project in 1996. At that time, Union Gas and Enbridge Gas Distribution (EGD and its predecessor) had both made applications to serve overlapping territories. The matter was ultimately settled by a mutually agreed upon division of the service territories. However, in the prior proceeding, the Board required both parties to meet with Board Staff to develop a common cost-benefit modelling method that could be used by the Board to evaluate the two utility proposals. This was done because the details in the cost-benefit analysis could be modified and the chosen statistical methodological approach varied to produce different results. This obfuscates the task at hand, which is to determine which utility can provide the most economical service.

In our submission, the Board should direct Board Staff to engage the same approach in these applications. Intervenors might be invited to participate—or observe, given the matter is largely of a technical nature. Its purpose is to provide the Board with equivalent methodologies to view the applications. As such, it would not address the subjective issues of customer forecasts or capital cost. Rather, this approach assures all parties that "different numbers have gone through the same process".

The filing requirements at Schedule C of Procedural Order No. 2 do not appear to us to contemplate the filing of the E.B.O. 188 form of cost-benefit analysis. As noted in the submissions below, VECC believes the universal standard to compare projects is a cost-benefit analysis.

5. How should the costs of proposals be compared? (e.g. $/month, $/system capacity, use of demand day, delivery capacity of the system for comparison)

In our view, the first step of this process is to ensure common methodology of the cost-benefit analysis of the project. Such analysis is well established in economic and business literature and widely used for analysing the value of capital projects. It establishes a net present value (NPV), which can then be used to compare the projects on an objective economic basis. Companies with different costs, load and customer forecasts, other revenues, and such will have different NPVs. In the simplest case, the applicant showing the highest NPV has the best proposal.

The second step is to provide the Board with a *pro forma* revenue requirement, which shows the requested standalone (fully allocated) operating costs of the new utility. In our view, the Board needs to consider whether a common rate plan or individual rate plans are required. In either case, such plans would allow for rate adjustments (e.g. inflation) during the period of the project analysis. Again the Board might find agreement on rate plans through a party conference. Similarly to the capital costs, the operating costs can then be analysed using discounted cash modelling. All other things being equal, the proposal with the most attractive combined capital and operating discounted value should be granted the franchise, but under the conditions of rate stability as described in this submission.

The Board might also consider what off-ramps or extraordinary circumstances would allow the utility to rebase inside of the rate stability period.

The third step is the development of the rate design to recover the base revenue requirement. Utilities could take varying approaches to this, such as minimizing load risk with a higher fixed charge, or vice versa.

Finally, the cost of any upstream capacity must be an input in this equation. As a practical matter, the incumbent utility is likely to bear this responsibility. This means that it may be possible for the incumbent utility to attempt to frustrate “franchise incursion” through unrealistic upstream cost proposals (both in timing and cost). As such, the Board should review these proposals separately and consider whether they also should be subject to “rate stability principles”.

6. Should measures be put in place to ensure completion of the proposed projects, and if so, what should these measures be?

In our submission, the Board should adopt the standard provisions it uses when issuing Certificates. This includes deadlines by which, if certain actions are not taken, the certificate may expire.

OTHER ISSUES

EB-2016-0004 states that contiguous expansion of the existing system with development on the edge of serviced areas would continue to be managed under the E.B.O. 188 framework. The decision also states that demarcation criterion are needed to separate those projects that would appropriately be dealt with in that manner rather than applying for new rates.

We are uncertain as to what differentiation in process is envisioned by this for a contiguous versus a non-contiguous application. However, it would appear to us that the Board foresees making a threshold decision as to whether the application is contiguous to the incumbent utility. If so, then as a practical matter, this decision should be made prior to the filing of any evidence.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

APRIL 27, 2017

[i] EB-2016-0004 Decision with Reasons, November 17, 2016, pg. 20