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BY EMAIL and RESS

Ontario Energy Board
2300 Yonge Street
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Toronto, Ontario
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June 21, 2017
Our File: EB20150179

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2015-0179 – Union Gas Ltd. Community Expansion – SEC Final Argument

We are counsel to the School Energy Coalition ("SEC"). Pursuant to Procedural Order No.9, enclosed please find SEC's Final Argument.

Yours very truly,
Shepherd Rubenstein P.C.

Original signed by

Mark Rubenstein

cc: Wayne McNally, SEC (by email)
Applicant & Intervenors (by email)

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF the Ontario Energy Board Act, 1998, c.15, Schedule B, and in particular, S. 90 thereof;

AND IN THE MATTER OF an Application by Union Gas Limited for an Order or Orders for approval of Union's Distribution System Expansion Project proposals;

AND IN THE MATTER OF an Application by Union Gas Limited for an Order or Orders granting leave to construct natural gas pipelines and ancillary facilities required to serve the communities of Milverton, Prince Township and, the Chippewas of Kettle and Stony Point First Nation and Lambton Shores.

FINAL ARGUMENT

OF THE

SCHOOL ENERGY COALITION

Overview

1. Union Gas Ltd. ("Union") filed an updated application for various rate and leave to construct approvals required to expand natural gas to four communities[1]. The application was revised to reflect the Board's findings in its Generic Community Expansion Decision.[2] This is the Final Argument of the School Energy Coalition ("SEC").

2. Based on the information provided to stakeholders from both, Union[3] and Enbridge[4], there are likely to be many similar community expansion applications in the coming years. SEC hopes that while the amounts at issue in this proceeding are relatively small (in terms of new customers and capital costs), clear guidance from the Board will allow for intervenors (such as SEC) to limit their need to intervene in

[1] 1) Kettle and Stony Point First Nation and Lambton Shores, 2) Milverton, Rock and Warburg, 3) Delaware Nation of Moraviantown First Nation, and 4) Prince Township.
[2] *Decision with Reasons* (EB-2016-0004 - Generic Proceeding on Community Expansion), November 17 2016 ["*Generic Expansion Decision*"]
[3] EB-2017-0091, Exhibit A, Tab 5, p.46
[4] EB-2017-0102, Exhibit D, Tab 3, Schedule, p.79

each individual community expansion application going forward. As the Board recognized in the Generic Community Expansion Decision, it "expects to refine the mechanism and features of the framework….through the adjudication of the initial applications and will seek submission from applicants and affected parties on implementation matters within those applications".[5] Guidance is required as there is clear dispute between and amongst Union and intervenors regarding the proper interpretation of the Generic Community Expansion Decision, in situations such as this application, where the franchise is uncontested, and the method for funding is by way of surcharge on base rates.

3. The evidence in this proceeding is that even with the proposed surcharge, and the expected conversion costs, new customers of the expansion community will see significant savings, including after taking into account the reduced electricity rates as a result of the recently announced Fair Hydro Plan.[6] The concern SEC has is that Union's proposal is inconsistent with the guidance provided by the new framework set out in the Generic Community Expansion Decision as it allows for a cross-subsidy between new and existing customers. In doing so, the projects are neither in the public interest nor does it lead to just and reasonable rates. SEC submits that with modifications to the proposal to ensure that it is consistent with the Generic Community Expansion Decision, the projects should be approved.[7]

4. SEC is supportive of the Board's goal of bringing natural gas to new communities where the economics makes sense. The Board's new framework for expansion into communities provides a way for projects that may not have been previously viable due to the regulatory rules set out in EBO 188[8], to potentially now be able to proceed. The utilities' new ability to charge stand-alone rates or surcharges in these new communities, avoids the problem of cross-subsidization between new and existing customers.[9]

Union Proposal

5. Union filed an updated application on March 31, 2017, in response to the Board's decision in the generic community expansion proceeding (Generic Community Expansion Decision).[10] Its revised application is a proposed uniform surcharge of $0.23m^3$ (called the System Expansion Surcharge or

[5] *Generic Expansion Decision*, p.21
[6] C.SEC.12; C.Staff.5(b)
[7] SEC is only taking a position regarding the economic and rate aspects of the proposed projects. SEC takes no position on other aspects such as Union's compliance with *the Environmental Guidelines for the Location, Construction and Operation of Hydrocarbon Pipelines and Facilities in Ontario*, its fulfillment of the duty to consult, as well as any land or construction matters.
[8] Final Report of the Board (EBO 188), January 30, 1998
[9] SEC recognizes that the term existing customers includes not just non-community expansion customers, but all customers including community expansion customers.
[10] See cover letter to Updated Application and Evidence, dated March 31 2017

“SES”), with the duration calculated to ensure, using the discounted cash flow (“DCF”) analysis, it reaches a Profitability Index (“PI”) for each project of 1.0 over a 40 year period.[11] The calculation of the DCF analysis and the 40 year term are consistent with the Board’s guidance in EBO 188.[12]

6. Union proposes that once the SES rate is approved in this proceeding, it would never change. The duration would only be adjusted if there were additional sources of municipal or government annual funding, or some source of aid-to-construction paid, that had not originally been forecasted. [13]

7. During the first 10 years of the project (the “stability period”), Union will accept the risk of under-forecasting the number of attachments, by imputing into any calculation of base rates, the revenue as if 100% of the forecasted attachments occurred.[14] After the 10 year period, the actual attachments and actual SES revenues will be used for ratemaking purposes.

8. Unlike number of attachments, Union does not propose to take on *any* risk for prudent overspending on capital costs.[15] It proposes that the actual capital costs will be sought for inclusion in rate base at the appropriate juncture (likely its next rebasing proceeding), and the full amount of capital (including any amounts potentially above forecast) that are deemed prudent will be sought for inclusion.

9. Union’s proposal has the effect that, if there are any variances between actual and forecast capital costs, and attachments rates (and their timing), the entire customer base will absorb the costs or benefit, not just customers of each expansion community. For customer attachments, this cross-subsidy will begin after year 10, and for capital costs, it will begin whenever Union next rebases. For example, if capital costs are higher than forecast, the actual PI over the 40 year duration of the project life will be below 1.0. Union will require additional revenue to fund the projects. Since Union is not proposing any adjustments to the SES, the additional revenue will come from existing ratepayers by increasing base rates.

[11] C.Staff.3; Exhibit A, Tab 1, Schedule 3, p.3 (Addendum)
[12] Exhibit A, Tab 2, Schedule A, p.3 (Updated); Exhibit A, Tab 2, Schedule B, p.7-8 (Updated); Exhibit A, Tab 2, Schedule C, p.6 (Updated); Exhibit A, Tab 2, Schedule D, p.6 (Updated);
[13] Letter from C. Keizer (Union Gas) to Ms. Walli (Board Secretary), June 6 2017 re: Settlement Status, Attachment, Q4 ["*Settlement Status Letter Attachment*”]
[14] *Settlement Status Letter Attachment,* Q1
[15] *Settlement Status Letter Attachment*, Q2

The Generic Community Expansion Decision

10. The Generic Community Expansion Decision's foundation is that expansion of natural gas to communities where there are sufficient savings to cover the costs of the project should not be subsidized by existing ratepayers:

> The OEB does not consider it appropriate or necessary to subsidize projects that result in sufficient savings to customers to cover the cost of the projects. What is required is a method of overcoming the upfront investment hurdle.[16]

11. It recognizes that the current impediment to further natural gas expansion was that under the regulatory rules at the time, incumbent utilities could only charge base rates. Because of those rules, significant upfront capital contributions were required to ensure the profitability of the project met a certain threshold set out in EBO 188 to ensure there was limited, if any, cross-subsidy between new and existing customers.[17] Municipalities and their customers would be unable or unwilling to pay what could be very significant upfront investments.

12. To remedy this problem, the Board determined that postage stamp would no longer be required for expansion communities. It would allow stand-alone rates for projects, as well as allowing for existing utilities to propose a surcharge over existing rates "to make up for the shortfall in revenue to cover the costs of the expansion".[18] The approach would allow "proponents to apply for rates that are geared towards the cost of the individual projects, or groups of projects, where they have similar cost drivers".[19] Because the projects would be self-financing, there was no risk to existing customers, and thus, there is limited need to test the profitability of the projects against existing ratepayers.[20]

13. In charging surcharges over base rates, the Board commented that it "does not depart from the mechanisms or principles embodied in the EBO 188 assessment."[21] By that, it appears the Board meant that the DCF and profitability analysis in EBO 188 is still the mechanism to determine if the proposed surcharge is sufficient.

[16] *Ibid*
[17] *Ibid*, p.18
[18] *Ibid*, p.21
[19] *Ibid*, p.19
[20] *Ibid*,, p.19
[21] *Ibid*,, p.21

14. While much of the decision appeared to discuss situations where there was competition to serve a franchise, the Board also addressed the issue of a single utility seeking to expand to a new community:

> Where there is no competition, a proponent will still be incented to have as low a rate as it can afford to encourage customers to connect and provide the return on the proponent's investment during the rate stability period. The proponent will also have to obtain approvals to adjust rates beyond the rate stability period.[22]

15. Union's proposal is inconsistent with this new approach since it still allows for a subsidy between existing and new ratepayers. Capital cost overruns are to be passed on to existing customers beginning when Union would next rebase, while customer attachment variances will be paid for by existing customers beginning in year 11.

16. In this proceeding, the Board commented in a letter to the to the Canadian Propane Association ("CPA") that issues such as forecast customer connections were not determinative, and did not even require testing, since the Generic Community Expansion Decision was clear that no subsidy will be permitted from existing to new customers:

> The OEB does not consider the issue of forecasted customer connections to be a determinative matter when a utility is permitted to charge standalone rates to new expansion communities. The profitability of a project is only relevant if the avoidance of a cross subsidy from existing to new customers is an issue. <u>The OEB ruled in the EB- 2016-0004 Generic Proceeding on Community Expansion Decision with Reasons that no subsidy will be permitted from existing customers to new customers; therefore, evidence related to forecasted customer connections does not need to be tested</u>.[23]

17. This confirms that Union's proposal is inconsistent with the Generic Community Expansion Decision since the forecast customer numbers are extremely important to ensuring there is no cross-subsidy between existing and new customers during the life of the project, unless the SES is adjusted after the 10 year stability period, which Union is proposing.

18. The Generic Community Expansion Decision's requirement for the stability period was to ensure that the applied for rates were "representative of the actual underpinning long-term costs".[24] Union's proposal only takes on part of the risk during the stability period. It is only imputing the shortfalls in customer attachments, not the capital costs of the project.

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[22] *Ibid*,, p.20-21
[23] Letter from Kirsten Walli (Board Secretary) to Mr. Richmond (Counsel to the CPA), dated May 2 2017, p.1
[24] *Generic Expansion Decision*, p.20

19. Setting the proper SES charge to match long-term costs is important to ensure that new customers were not being enticed with lower than appropriate rates, to only have them increased soon after they are connected. It ensures that all fuels can compete on a fair playing surface.[25] The Board reiterated this in its letter in this proceeding to the CPA:

> The OEB considers the issue of a rate stability period to be important as it will ensure that rates applied for are representative of the actual underpinning long-term costs, and it will place forecast risk for the rate stability period on utilities.[26]

20. It is important for the Board to set clear guidelines now regarding what could happen after the 10 year stability period has ended so Union knows how it should market itself to potential customers in the expansion communities. Potential customers in these expansion communities should be aware now, that the SES may last longer (or shorter) than originally proposed, and the amount may increase (or decrease).

Appropriate Approach

21. The Board must ensure that Union's proposal does not allow for a cross-subsidy between existing and new customers – in either direction. New customers should be required to pay for the cost of the project, in the same way customers of a new utility with no existing customers in the province would. If the costs are lower, and the forecast customers exceed what was projected, customers of the expansion community should benefit from having a lower SES rate or duration. If the opposite occurs, those customers should be required to pay for it.

22. SEC submits after the 10 year stability period is over, Union should be required to re-run the EBO 188 DCF analysis, updating only for the actual prudently incurred capital costs and the actual customer attachments, to determine an updated PI. If that number differs from the original PI in this application, then Union should adjust the SES to ensure the project has a PI of 1.0 over the first 40 years of the project. This would be consistent with the EBO analysis itself, which only takes into account as inputs, the capital costs and customer attachments over the first 10 years of the project.[27]

23. This approach allows for existing utilities to charge surcharges over existing rates, while "not depart[ing] from the mechanics or principles embodied in the EBO 188 assessment"[28], and yet ensuring there is limited to no cross-subsidy. Both elements are contemplated by Generic Community Expansion Decision.

[25] *Ibid*, p.4
[26] Letter from Kirsten Walli (Board Secretary) to Mr. Richmond (Counsel to the CPA), dated May 2 2017, p.1
[27] Final Report of the Board (EBO 188), January 30, 1998, s.3.3.2
[28] *Generic Expansion Decision*, p.20

24. It would be both unfair and explicitly inconsistent with the Generic Community Expansion Decision, if the Board treated customers who are being served by a new utility without any existing customer base, differently than a utility with an existing customer base:

> With the ability to propose new rates there is no need to test the profitability of the projects against existing rates. Proposals will need to be self-financing and therefore there will be no risk to existing ratepayers. <u>This would also be fair to suppliers of other fuel as one fuel choice will not be subsidize, and to new entrants who do not have existing customer base to subsidize expansions.</u>[29] [emphasis added]

25. This is what Union's current proposal allows: a cross-subsidy if costs and attachment rates differ. In addition, the proposal is inconsistent with the Generic Community Expansion Decision, because it does not allow customers of expansion communities to benefit from higher than forecast attachment rates. The Board was clear that over the longer-term those expansion areas should benefit with lower rates due to more than anticipated growth:

> <u>This approach would allow existing distributors and new entrants alike to propose new rate zones that would cover the cost of serving expansion areas. If there is more growth in these areas than initially anticipated, over the long term the rates will be lower.</u> These may eventually be harmonized with a utility's other distribution, or may continue as separate rates as with Union North and Union South.[30] [emphasizes added]

26. Ensuring that the SES is adjusted to reflect variances between the forecast capital costs and attachment rates set out in the evidence in the application, and the actuals, is central to complying with the Generic Community Expansion Decision.

27. In adjusting the SES after year 10 to ensure the PI remains 1.0, consistent with EBO 188, the maximum duration of the project should be capped at 40 years. At the same time, SEC does accept Union's explanation regarding the benefits of having a uniform SES rate through the expansion communities, and that it is the duration that should differ for each project.[31] Thus, when recalculating the SES to ensure the PI remains at 1.0, if the resulting SES duration would be greater than 40 years, then only at that point it would be appropriate to adjust the amount.

28. The only other scenario that may also require a change in the SES rate or duration in the future is if Union undertakes a wholesale change to its depreciation rates. The current EBO 188 DCF analysis is

[29] *Generic Expansion Decision*, p.19
[30] *Ibid*, p.19
[31] C.SEC.7

based on the general 40-year life of Union's major assets. As the Board is aware, Union is reviewing its overall depreciation rates in light of significant expected changes to natural gas use in the future as a result of Government policy by way of the Cap and Trade program and Climate Change Action Plan.[32] This may lead to a change in the next rebasing proceeding, and if not, then it is likely at some point over the next 40 years.

29. The Board should also not be swayed by any potential argument that Union may make regarding leaving it to future panels to decide what to do if capital costs or attachment rates materiality differ from what is forecasted in this approval. While SEC recognizes the Board cannot bind future panels, similar to the framework it outlined in the Generic Community Expansion Decision, it can set expectations for all parties on a going forward basis on what the Board's policy is. It is even more important for the purpose of ensuring Union is transparent with potential new customers in expansion communities so they can properly consider the benefits and risks of signing up. Union should neither be able to tell those customers that the SES will definitely end on a specific date, nor that the amount will remain the same under all circumstances. It is important they are aware that the forecast SES amount and duration is based on Union's forecast of the project's capital costs and attachment rates. If those end up differing from the forecast, then the SES duration, and potentially the amount, will need to change.

Summary

30. SEC submits that consistent with the Generic Community Expansion Decision, existing customers should not subsidize expansion projects, and vice versa. The Board should require Union to re-run the EBO 188 DCF analysis after year 10, using actuals, and capital cost and customer attachments, to ensure that each project PI remains at l.0. If it is not, the duration, and if required, the amount, of the SES should be adjusted accordingly.

31. The Board should also ensure Union's proposed SES is reflective of its long-term costs by requiring Union to take on the risk of capital cost overruns during the first 10 year period, as it is proposing to do with customer attachments. In making these changes to Union's proposal, the projects will be in the public interest and leave to construct should be approved.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

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[32] See EB-2016-0186, Tr.1, p.121:

> MR. ISHERWOOD: Yes. We're doing a depreciation study for the rebasing, and that will look at the entire existing system.

Original signed by

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Mark Rubenstein
Counsel to the School Energy Coalition