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BY EMAIL

July 20, 2017

Ms. Kirsten Walli
OEB Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, Suite 2700
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: OEB Staff Progress Update: South Bruce Expansion Applications
OEB File No: EB-2016-0137 | EB-2016-0138 | EB-2016-0139

Pursuant to Procedural Order No. 6 dated June 27, 2017, please find attached OEB Staff's progress report with respect to the joint session convened by the OEB on July 13, 2017.

Yours truly,

Originally Signed By

Azalyn Manzano
Case Manager

/attach.

OEB STAFF PROGRESS UPDATE

South Bruce Expansion Applications

EB-2016-0137 | EB-2017-0138 | EB-2017-0139

July 20, 2017

INTRODUCTION

EPCOR Southern Bruce Gas Inc. (EPCOR) filed applications with the Ontario Energy Board (OEB) on March 24, 2016 under sections 8 and 9 of the Municipal Franchises Act, R.S.O. 1990, c. M.55, seeking approval for its franchise agreements with and Certificates of Public Convenience and Necessity for the Municipality of Arran-Elderslie, Municipality of Kincardine and the Township of Huron-Kinloss (“the South Bruce Expansion Applications”).

Procedural Order No. 1, which was issued on January 5, 2017, directed other parties interested in serving the areas covered by the South Bruce Expansion Applications to notify the OEB of their interest. Union Gas Limited (Union) filed a letter dated January 19, 2017 notifying the OEB of their interest in serving the areas covered by the South Bruce Expansion Applications.

In accordance with the OEB’s Procedural Order No. 6 dated June 27, 2017, EPCOR and Union Gas participated in a joint session with OEB staff with the following objectives:

- To jointly develop and agree on a Common Infrastructure Plan (CIP)
- To develop proposed comparison criteria
- To determine other parameters as necessary to allow the proponents to file an application based on the CIP
- To develop a standard set of assumptions regarding permissible rate adjustments, and
- To determine the time needed by proponents to prepare proposals.

PROGRESS UPDATE

The proponents worked collaboratively to develop a proposal which they believe will allow for a fair and competitive process. While not all infrastructure parameters are recommended to be set as common, the proposal provides a framework for the utilities to present and for the panel to evaluate the competing projects in a manner that the proponents accept as reasonable. The proponents balanced ease of OEB review - stated in Procedural Order No.6 as a desire to avoid the need to compare multi-faceted proposals designed to address a myriad of various, often competing, interests in a selection process – against the OEB’s concept of allowing for a hearing of alternative, competing bids, as described in the Decision on the Generic Proceeding on Community

Expansion (Generic Decision)[1]. Parties felt that setting all parameters as common removed the ability for proponents to develop innovative, lower cost solutions for serving the South Bruce communities, but they agreed upon the importance of having the proposals submitted to the OEB be comparable and developed with parameters that would prevent gaming. Proponents believe that the CIP proposal below accomplishes these objectives in a balanced way.

Ultimately, the parties agreed upon the appropriate treatment of many elements: not only whether the element should be set in common or left to competition, but also what the parameter should be set to, if determined to be common. There were, however, a number of areas where parties did not agree. Proponents have requested that the OEB allow for submissions on the areas of disagreement, with oral submissions being the proponents' preference. In addition, parties also discussed what might constitute permissible rate adjustments during the rate stability period.

Agreement on CIP

Below is a list of elements that parties agreed upon with respect to a Common Infrastructure Plan:

Communities
Proponents agreed that the CIP should provide service to the following communities: Chesley, Inverhuron, Paisley, Tiverton, Kincardine, Lucknow, Lurgan Beach, Point Clark, Ripley, and Bruce Energy Centre Industrial Park, as shown in Appendix A.

Comparison Criteria
The proponents agreed to three criteria for comparison purposes. Based on the group's understanding of Procedural Order No. 6, parties agreed that the successful proponent would be held to these criteria after adjusting them to account for any grant from the Natural Gas Grant Program and cap and trade costs (as identified below), in their future rate and LTC applications. Proponents agreed that selection of only a single criterion provides an opportunity for gaming. For example, simply selecting revenue requirement $/m^3 as the decision metric could provide an incentive for proponents to only select service to the most profitable customers, whereas proponents understand that the goal of community expansion is to facilitate access to natural gas services to many customers. Proponents agreed to the following proposed comparison criteria:

[1] EB-2016-0004 p. 19

1. **$/m³** –the sum of total (gross) annual revenue requirement for 10 years divided by the total volumes for 10 years

2. **Number of customer years** – the cumulative number of customers connected over the 10 year rate stability period multiplied by the number of years each customer is connected
   For example:

   One customer is added in year 1, and another customer is added in year 2. By the end of year two, the cumulative number of customers connected (or customer years) is 3.

   (Customer 1 x 2 years) + (Customer 2 x 1 year) = 3 Customer Years.

   For simplicity, the timing of a connection within a specific year is not factored into the above.

3. **Cumulative volume (m3)** – the cumulative volume of throughput per year, over the ten-year rate stability period. This metric would be calculated in a similar manner to the second criteria, but based on the volume consumed by the customers to better depict the various customer classes and their demand. Credit for volumes from new customer additions in a specific year are based on connection to the system in the middle of the year, with the exception of large industrial and commercial customers for whom a specific connection period can be determined by the proponent.

Infrastructure Specifications

Proponents decided that infrastructure specifications, such as the size of the pipeline to be built and its routing, should be left to competition. Proponents agreed to include the costs and details of infrastructure in their proposals, but that the specifications should not be set as common in the CIP.

Customer Attachments

Both proponents agreed that the number of attachments should be competitive. Proponents agreed to file their own forecast of attachments as part of their proposals, and that the successful proponent would then be held to its forecast for rate making purposes. Proponents felt that they each might be willing to take on different levels of risk and marketing activities, and that setting the number of attachments as common would remove a significant component of the competition. Proponents felt that the proposed comparison metrics would illuminate any potential differences between their proposals and provide information on a levelized basis.

Construction Schedule

Proponents agreed to be held to a common construction schedule for gas mains, based on certain assumed timelines for OEB decisions. Proponents agreed to construct gas mains to all of the communities to be served within two years from the commencement of construction, which is currently expected to begin by March 2019 based on the following proposed schedule:

August 2017	Decision on the elements of an appropriate bidding framework on which the competitors seek further directions from the OEB
October 2017	Proposals for competition due
December 2017	Decision for successful proponent
March 2018	Filing of pre-filed evidence for LTC, rates, Franchise and Certificate application
August 2018	LTC approval
March 2019	Construction begins in South Bruce

Proponents agreed that the timing of customer connections (service lines and metering installations) each year during the rate stability period should be left to competition as it is directly impacted by projected attachment levels and marketing activities. Proponents agreed to include the costs and timing of connection lines in their proposals to the OEB, but that these would not be set as common in the CIP.

Forecast Horizon

Proponents agreed that the customer attachment and volume forecasts should be done over a 10 year horizon.

Customer Consumption

Proponents agreed to use the same value for the average annual usage of mass market consumers. Proponents agreed to work together to develop common consumption levels for each mass market segment, including residential, small/medium commercial, small/medium industrial, hospitals, schools and other municipal or institutional consumers.

Proponents agreed that consumption levels forecast for any large commercial or industrial customers should not be set in common, but rather left to competition in each proponent’s proposal.

Depreciation Rates
Proponents agreed that depreciation rates should be common, and they settled on using Union's OEB-approved depreciation rates.

Capital Structure
Proponents agreed that the debt/equity structure should be common for both proponents. They agreed to use 64% / 36% as per Union's approved deemed debt/equity ratio.

Proponents agreed that the cost of debt and cost of equity, however, should remain competitive and not be set in advance.

Union notes that proponents each have potential advantages in differing parameters which should remain open to competition, and it feels strongly that any of these parameters, like cost of debt, cost of equity, and OM&A costs, should be considered collectively. Union believes that if the OEB determines that any one of these parameters needs to be fixed between proponents, then all three need to be.

Government Grants and Municipal Contributions and Aid to Construction
Proponents agreed that government grants and contributions from municipalities should not be included in the proposals. Proponents also agreed that any Aid to Construction required for customers to connect to the system should be excluded. Rather, the revenue requirement should be stated on a gross basis. Proponents believe this treatment is appropriate as amounts to be received, if any, are unknown at this time.

DSM Costs
Proponents agreed that although the successful distributor is likely to implement some form of Demand-Side Management (DSM) program in the South Bruce communities, the cost and nature of what is ultimately offered may be different from other areas given that some of these customers will be installing new, efficient equipment. As well, these costs would be required by either proponent if successful, and can be approved by the OEB in a future proceeding. Therefore, proponents determined that these costs should not be included in the competitive proposals to the OEB.

Cap and Trade Costs
Proponents determined that Cap and Trade costs should not be included in the proposals to the OEB. These costs would be required by either proponent if successful, and would essentially flow through to customers.

Taxes
Proponents agreed that tax rates should be common and included in the proposals; any potential for a tax holiday from the municipality should not be taken into account.

Service Levels
Proponents determined that both proponents should have to plan for operations and maintenance that would meet the service levels identified in the Gas Distribution Access Rules (GDAR).

"Other" or "Intangible" Category
The parties agreed that an "Other" and "Intangible" category should be available to proponents when submitting their proposals where they could cover any soft issues or things outside of the financial calculations. The OEB could then decide whether to take these matters into account in its decision.

Disagreements on CIP

There were a few elements that parties were unable to reach agreement on. As stated above, proponents have requested that the OEB allow for submissions on these areas of disagreement. It should be noted that as a result of this request, the summary of the proponents' views below does not contain support or rationale for the proponents' positions as would be contained in a submission.

Upstream Reinforcement
Proponents could not agree whether the costs of incremental upstream infrastructure which will be required to serve the communities in South Bruce should be considered in the CIP proposals submitted to the OEB or not. Both proponents agreed that upstream costs will need to be addressed by the successful proponent in its rate application.

Union's position was that upstream reinforcement costs should be included in the CIP revenue requirement given that the applicable upstream costs may vary due to potentially different connection points and/or loads and volumes, depending on each proponent's specific proposal. Union believes that not including the upstream reinforcement costs in the CIP would result in the OEB comparing $/m^3 figures that are artificially low, and would result in revenue requirements stemming from the successful proponent's LTC application being greater than expected. Union noted that its position is supported by the Generic Decision which states that "advancing upstream system expansion and enhancements should be considered in every case where they are shown to exist".[2] Union states that it has a methodology that will be applied consistently to arrive at the costs for this reinforcement for both proponents' proposals, and that the OEB can examine that methodology in assessing the filed proposals. OEB Staff suggests that it may be helpful for Union to provide details of this methodology in its submission so that this information can be understood in advance of proposals being filed with the OEB.

EPCOR's position was that upstream reinforcement costs should not be included in the revenue requirement for the CIP proposals, given that, if successful, EPCOR would be held to a unit metric that was based on cost estimates provided by Union. In addition, EPCOR felt that it was unable to control or test the assumptions and prudency of costs for any upstream reinforcements to be performed by Union. EPCOR believes this is consistent with the OEB's determination in the Generic Decision that upstream reinforcement costs must be the same regardless of the utility proposing the expansion, and must be separately delineated in LTC applications[3].

Inflation Costs

Both proponents agreed that inflationary adjustments should be taken into account for capital and OM&A costs during the 10 year forecast period, and that the inflation rate should be the same. However, proponents were unable to agree on how the inflation rate should be set.

EPCOR felt that the revenue requirement submitted to the OEB should include a common inflation index (or basket of indices) and that the successful proponent should be held to this index during the rate stability period. In other words, inflationary expectations would be built into each year's revenue requirement.

Union is in favour of applying a common annual factor to capital and OM&A costs each year in recognition of inflation. Union feels the common factor should be no higher than an estimated long term inflation rate, and could be based on recent historical GDP-IPPI.

OM&A Costing Methodology

Proponents disagreed as to whether OM&A costs to be included in the proposals should be fully allocated or incremental costs only.

[2] EB-2016-0004 p. 20
[3] EB-2016-0004 p. 20

EPCOR's position was that the OM&A costs should be fully allocated to reflect the OEB's desire for stand-alone rates (as per the Generic Decision and the Partial Decision on the Issues List and Procedural Order No. 6 in this proceeding). EPCOR's position is that incremental costs are appropriate for conventional system expansions evaluated using EBO 188 (where new customers pay existing utility rates), but not for community expansions contemplated by the Generic Decision, where standalone rates will apply.

Union's position was that OM&A costs should be incremental, consistent with the approach specified under EBO 188. Without using the EBO 188 approach, Union felt that new customers would be cross-subsidizing existing Union customers. Union also stated that the resulting $\$/m^3$ from the CIP would be overstated when compared to what the proponent should expect to recover in rates, given that in adding expansion area customers, fixed components of Union's costs, which are being recovered in current rates by pre-existing ratepayers, do not change. Union also said that the competition based on submitted proposals should be based on fact, rather than fiction, and that fully allocated OM&A costs would be fictional. As noted above, Union believes that proponents each have potential advantages in differing parameters which should remain open to competition, and it feels strongly that these parameters, such as cost of debt, cost of equity, and OM&A costs, should be considered collectively.

Treatment of Capital Costs

Proponents were unable to agree on the treatment of capital costs beyond the 10 year stability period.

EPCOR's position was that the successful proponent should take on the risk for capital cost overruns (compared to the capital costs included in the 10 year period covered by the CIP). Consistent with that, EPCOR stated that revenue requirements for year 11 and beyond should not include any type of true up for cost overruns incurred during the first 10 years.

Union felt that the successful proponent should take on any volume risk through the rate stability period, but that actual capital could enter rate base for ratemaking purposes subject to the Board's approval of prudency, at first opportunity. Union believes the treatment of rate impacts beyond year 10 due to cost or volume adjustments should be determined by the OEB at that time. Union also believes that the competition must be based on costs during the rate stability period; if one proponent wants to make commitments beyond that, it can be covered off in the "other" section of their application. However, Union states that any such promise must be followed through with in year 11 and beyond if it is accepted.

Other CIP Parameters
Subsequent to the joint session, Union identified an additional three parameters that it felt should be set in common: interest during construction, commodity costs, and royalty payments to the municipality. Discussions have not yet been held between proponents to determine whether there is agreement on the treatment of these parameters. OEB staff would suggest adding these items to the issues for submissions from proponents.

Permissible Rate Adjustments

The joint session attendees also discussed what might constitute permissible rate adjustments during the rate stability period. Parties agreed that they should include Z-factor adjustments (as per the OEB's usual Z-factor criteria).

EPCOR's agreement is based on the expectation that there would be a definitive list of Z-factor adjustments and in particular that the successful proponent be restricted from recovering (by way of a Z-factor) any costs that it assumed the risk for in its CIP submission.

Parties agreed that there should also be some form of inflationary adjustment, but requested more time to consider what this might be.

When discussing rate adjustments, EPCOR also stated its view that the rates should be standalone, without reference to existing rates. EPCOR's concern was that use of an existing rate plus a premium (with only the premium held static) would allow a proponent to pass costs through that it might otherwise not be permitted to, as a result of a rate case related to the existing rate (e.g. Union's Community Expansion Proceeding[4]). A detailed discussion on the rate framework, however, did not take place during the joint session.

CONCLUSION

OEB staff believes that the joint session was a productive discussion, which resulted in a framework that will allow utilities to present, and for the panel to evaluate, the competing projects in a manner that is both fair and competitive. OEB staff believes that

[4] EB-2015-0179

the CIP as developed should be adopted. Please refer to Appendix B for a summary of the proposed treatment for the CIP elements.

OEB Staff also notes that the parties have requested clarification from the panel on the process to be followed after the CIP proposals have been received. For example, will both utilities have the opportunity to ask questions of the other proponent's proposal and to make submissions to the panel before a selection of the successful bidder is made, or might only clarifying questions from the panel and OEB staff be asked?

APPENDIX A

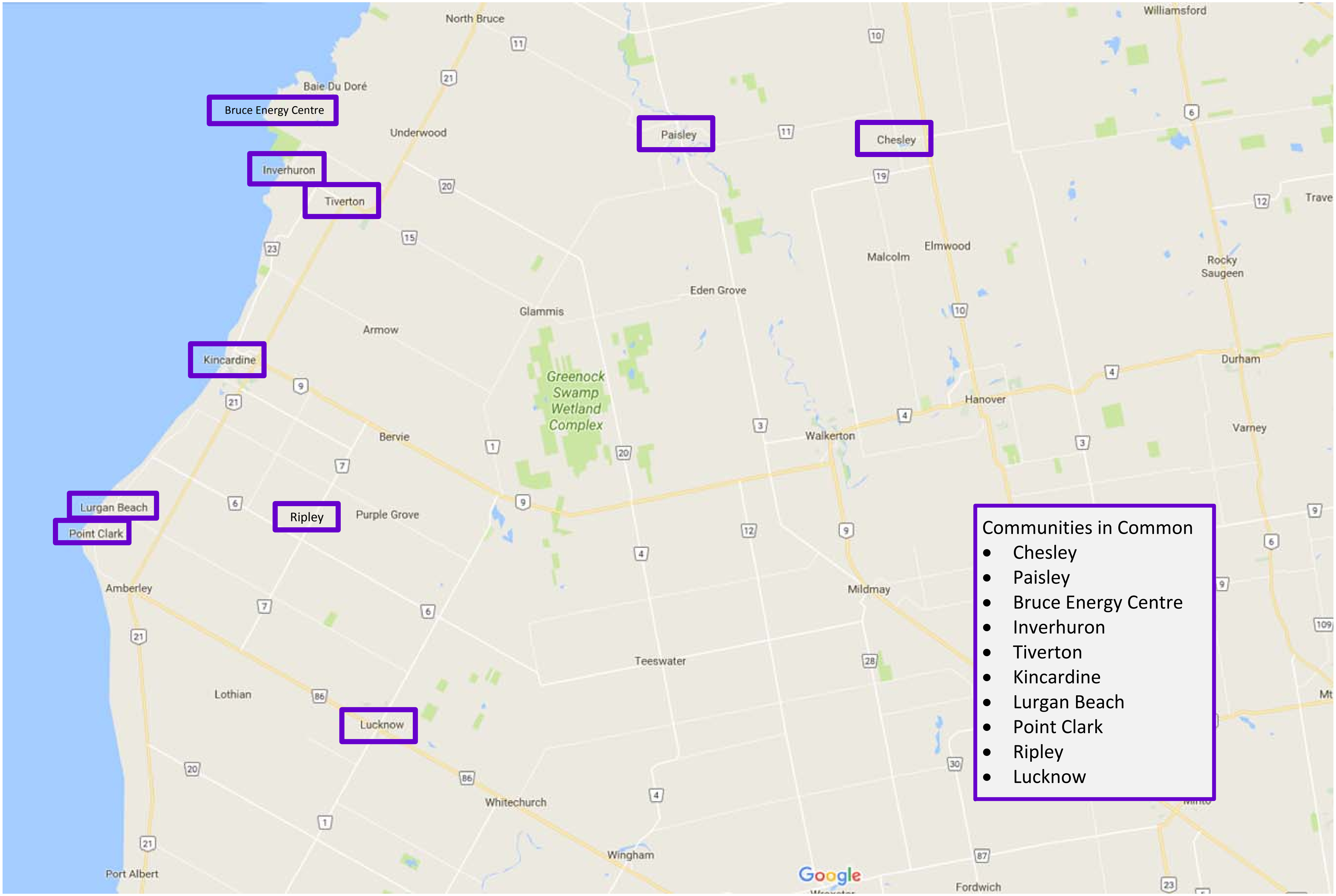
TO THE

OEB STAFF PROGRESS UPDATE

South Bruce Expansion Applications

EB-2016-0137 | EB-2017-0138 | EB-2017-0139

July 20, 2017


Bruce Energy Centre
Inverhuron
Tiverton
Kincardine
Lurgan Beach
Point Clark
Ripley
Lucknow
Paisley
Chesley
North Bruce
Baie Du Doré
Underwood
Armow
Glammis
Eden Grove
Malcolm
Elmwood
Williamsford
Rocky Saugeen
Durham
Hanover
Walkerton
Varney
Bervie
Purple Grove
Greenock Swamp Wetland Complex
Mildmay
Teeswater
Amberley
Lothian
Whitechurch
Wingham
Port Albert
Fordwich
Communities in Common
Chesley
Paisley
Bruce Energy Centre
Inverhuron
Tiverton
Kincardine
Lurgan Beach
Point Clark
Ripley
Lucknow

APPENDIX B

TO THE

OEB STAFF PROGRESS UPDATE

South Bruce Expansion Applications

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Summary of Treatment of CIP Elements

Element	Set as Common for CIP	Open to Competition	Excluded from CIP	In Dispute
Communities	X			
Comparison Criteria	X			
Infrastructure specifications		X		
Customer Attachments		X		
Construction Schedule				
Gas Mains	X			
Customer Connections		X		
Forecast Horizon	X			
Customer Consumption				
Mass Market Consumers	X			
S/M/L Commercial, S/M Industrial Consumers	X			
Large Industrial Consumers		X		
Depreciation Rates	X			
Capital Structure				
Debt/Equity Ratio	X			
Cost of Debt / Cost of Equity		X		
Government Grants & Municipal Contributions			X	
DSM Costs			X	
Cap and Trade Costs			X	
Taxes	X			
Service Levels	X			
“Other” or “Intangible” Category		X		
Upstream Reinforcement				X
Inflation Costs	X			X
OM&A Costing Methodology				X
Range of Accuracy for Estimates				X
Other Proposed CIP Parameters				
Interest During Construction				X
Commodity Costs				X
Royalty Payments				X