VIA E-MAIL

January 26, 2017

Ontario Energy Board
Attn: Kirsten Walli, Board Secretary
P.O. Box 2319
27th Floor, 2300 Yonge Street
Toronto ON M4P 1E4

RE: EB-2017-0306 – EDG/Union Merger – FRPO Submissions on Draft Issues List

Please find attached the submissions of the Federation of Rental-housing Providers ("FRPO") in respect of the draft issues lists submitted by the utilities and the ratepayer group.

Respectfully Submitted on Behalf of FRPO,

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Parties to EB-2017-0306

INTRODUCTION

The merger of two utilities requires the Board's approval. That is not in question. And we trust that no party would argue that the Board has been given very broad powers in its legislated mandate to carry out its duties under the Act. Since the Board has agreed to hear submissions on the scope and content of the issues list, it stands to reason that the regimented implementation of an issues list based on an electric utilities' MAAD's application is not required. In fact, as the Board panel's discretion is not fettered by any past decision of the Board or Board-approved guidelines, we respectfully submit that the hearing of submissions by the parties is an appropriate part of due process and we appreciate the opportunity.

We respectfully submit that Ratepayer group proposed issues list, as submitted to the Board by IGUA on January 17, 2018, serves the Board and public interest. Our submissions are organized in the following categories:

1) The MAAD's policy, the Consolidation Handbook and resulting Rate-making frameworks were not designed for nor did they contemplate the merger to form AMALCO.
2) The issues list provided by the Ratepayer group is more generic and comprehensive giving the Board an opportunity to consider the full impact of the proposed merger.
3) The public interest test is not as simple as has been portrayed by the applicants' issues list.

As a result, we urge the Board to consider the scope and impact of ratepayers' concerns and adopt the more fulsome approach embedded in the Ratepayer-proposed issues list ("Ratepayer List").

1) <u>It is not Appropriate to Apply the MAAD's Policy to the proposed Merger</u>

In our view, the scope of this merger is substantially different from the merging of electric utilities for which MAAD's policy and associated Handbook were designed to facilitate and, in fact, incent. While the applicants rely on cross-referencing between respective documents to cite applicability to gas equal to electricity, we urge the Board to consider the impetus for the policies and associated guidance.

As a definitive example, the introduction to the Handbook clearly states the genesis and intent of the Consolidation Handbook:

The Commission on the Reform of Ontario's Public Services, the Distribution Sector Review Panel and the Premiers Advisory Council on Government Assets have all recommended a

reduction in the number of local distribution companies in Ontario and have endorsed consolidation. According to these reports, consolidation can increase efficiency in the electricity distribution sector through the creation of economies of scale and/or contiguity. Consolidation permits a larger scale of operation with the result that customers can be served at a lower per customer cost. Consolidations that eliminate geographical boundaries between distribution areas result in a more efficient distribution system.

It would be pure hyperbole to suggest that these same commission, panel and council studied Ontario's natural gas industry and drew the conclusion that consolidation of the **TWO** largest distribution companies serving 99% of all gas customers could increase efficiency of the gas distribution sector through the creation of economies of scale and/or contiguity. The proposed merger to form AMALCO seemingly was so far off the radar that the Handbook does not even reference the word "gas".

Arms length, non-regulated parties do not need nor seek regulatory incentives to merge with or acquire another company in the same market segment. In this case, the parent companies of the respective utilities did not need an incentive to come together for their reasons. Ultimately, without treading into facts or opinions outside the jurisdiction of this Board and the concerns of this panel, Principal-Agency Theory[1] would dictate that they did so acting in the interest of the shareholder.

The transaction created non-arms length affiliates of Enbridge Gas Distribution ("EGD") and Union Gas ('Union"). As individual companies under Enbridge Inc. ("EI"), the two companies operated their own utilities in a "business as usual" fashion. In fact, many informal inquiries in stakeholder meetings and formal inquiries in interrogatories about the potential of merging or shared services were met with the same mantra from each utility specifically "two companies, business as usual".

However, as is the discretion of a single corporate parent of two wholly-owned companies, the stated intent of companies changed. That begs the question: Does the merger of EGD and Union need the incentives and facilitation embedded in the MAAD's policy? The answer is no. The parent companies merged without an incentive and their merger was not contingent on the Board's approval nor any incentive to capture transition or transaction costs. In the case of the utilities, by their own evidence, the transaction costs are not significant. What the application of the MAAD's policy could provide the utilities is a long-term era of protecting the financial benefits from a requirement to share those benefits with ratepayers. The application of the policy and strict application of the Handbook criteria

[1] The executive of the company not acting in the interests of the shareholders would constitute a Principal-Agent problem see "*Fiduciary Rationality and Public Policy: The Theory of Agency and Some Consequences"* presented at the annual meeting American Political Science Association in 1973.

would result in a sheltering of the resulting utility profits depriving ratepayers of a just and reasonable share of savings that would otherwise be available if the two companies stayed separate and re-based their costs separately with an appropriate reduction in corporate costs as a result of a single, corporate parent (more under section 3)).

As described above, we believe it is clear that the MAAD's policy and Consolidation Handbook were not intended to be applied to the two mega-gas utilities. However, in the event that the Board determines that some aspects of the principles of the Handbook for Utility Rate Applications were appropriate, it is our submission that the application to the gas utilities ought to recognize the scope of impact of the proposed merger. Page 21 of the Rates Handbook includes:

> *The OEB will consider non-regulated activities and transactions with affiliates in the context of their effect on the regulated rates to customers to ensure there are no cross subsidies that negatively affect these regulated customers.*

Issues 7 and 8 of the Ratepayer List provide the Board opportunity to ensure this aspect of the merger is considered. There is no such scope on original or revised proposed issues list of the utilities. The impact of this consideration is amplified when the importance of storage to the Ontario natural gas market is considered (more under Section 2)).

The applicants have relied on the applicability of the MAAD's policy and the Consolidation Handbook to narrow their proposed issues list. In our view, beyond some cross-referenced guidelines, there is no evidence that the informed studies that precipitated this thrust of the Board's work considered natural gas. We conclude that creating one natural gas utility to serve effectively the whole province was not the intent of this initiative.

2) <u>The Impacts of the Proposed Merger Necessitate a Comprehensive Review</u>

The Ratepayer List was formulated by many experienced professionals who have considered the berth of issues emanating from the proposed merger that are under the Board's purview. It was intentionally crafted to provide the Board with informed consideration of issues that may require determination in this proceeding. Upon discovery, some issues may not require significant adjudication, however, that may not be evident until that time.

On the other hand, the utilities initially submitted a very narrow list of issues drawn from a reliance on the Consolidation Handbook. Many of those proposed issues are constructed in a leading fashion that could narrow the scope of discovery and potentially the submission of potential conditions which would mitigate unintended consequences of an approval. In our

respectful submission, the Ratepayer List maximizes the efficacy of the proceeding for the Board and in the public interest.

So as not to argue the case before discovery we offer only a couple of examples of the concerns we believe ought to be examined: Storage and Transportation.

a) **Storage**

Storage assets have been operated by utilities for decades in the interest of balancing variations in seasonal consumption and as a hedge against price risks during peak demand conditions. In this last decade, the regulatory construct surrounding the benefits of these assets changed dramatically with the Natural Gas Electricity Interface Review ("NGEIR") decision. Through a series of decisions by this Board, accounting standards have been established to separate utility from non-utility costs.

The decision precipitated the potential for a market to form with Enbridge Inc. developing its first market based storage to compete with Union's existing and newly-developed non-utility storage. This coupled with a few smaller, independent, non-utility storage developers created the potential for choice of market-based storage providers in Ontario. Fast-forwarding a decade later, this merger along with the purchase interests in the independent providers by Union over the years, results in Enbridge Inc. controlling over 95% of the market-based storage in Ontario and almost all of the storage that feeds directly in Dawn.

This situation creates a significant risk for ratepayers and the public interest for a couple of reasons:

First, EGD in-franchise customers require market-based storage to supplement EGD-owned cost-based storage. Most of that storage is currently bought from Union at market-based rates in a non-transparent market. With the margins available from the prices paid over the cost of storage flowing to Enbridge Inc., ratepayers are at risk in a market with very limited supply and no transparency.

Second, most marketers who provide commodity service to direct purchase customers need storage to balance their business transactions and needs of their customers. With this consolidation, marketers will have limited choice of service providers to serve their customers creating risks of increasing costs for customers if storage margins rise due to lack of competition. This situation could impact not only the cost of commodity in Ontario but also competitive position of industries who consume large quantities of gas and are more likely to rely on these markets.

We understand the utilities may argue that the NGEIR decision determined that Ontario storage competed with storage in other jurisdictions in a broader geographic market area which is correct. However, without evidence in this proceeding, it is hard for the Board to know if that is the case without assessing if this competition has occurred sufficiently to protect the public interest. In addition, what is different now is that there would be virtually one market-based storage provider to Dawn. This is the same Dawn that is one of two biggest hubs for natural gas trading in central North America and one of only a few locations that these same utilities require their direct purchase customers deliver.

While this may be seen as competition issue, the Competition Bureau has a history of deferring to the regulator who has more direct market knowledge and whose jurisdiction includes service at risk.

Lastly, there are some who may argue that now that EGD and Union are one company, should EGD's incremental storage needs above the currently-owned EGD storage be met, in part, by excess utility storage held by Union for its customers.

b) **Transportation**

With evolution of natural gas drilling in North American, Ontario supply has been shifting to the Appalachian Basin. While some of the intra-Ontario transportation is provided by TransCanada pipelines, the fastest growing route, moving, arguably, the most gas in and through Ontario is the Dawn-Parkway system. As system operator of this route, Union's rates and some aspects of its operations are overseen by the Board.

The shipper with the largest quantity of contract rights is EGD. The proposed merger creates a situation where EGD shifts or moves from being a contracting shipper to an owner of the assets. What are the implications of this shift for the ratepayers of each of the existing utilities and other shippers. Also, this shift creates potential issues of market access on a non-discriminatory basis for other shippers on the system.

The above concerns focus on intra-Ontario transport. In addition, there are significant concerns about the choices exercised on behalf of ratepayers by the utilities in their gas supply plans. We acknowledge that the impact of the merger on these plans may be the subject of the Board's consultation on LDC Gas Supply plans but, nonetheless, it is an impact that must be considered at some point in some Board forum.

In our view, it is these types of issues as described above, and many others, that argue for a more open and comprehensive review of the public interest aspects of the proposed merger. We find it very telling that after considering ratepayer concerns regarding storage and transportation, the utilities updated their proposed list to include the "Other Statutory Objectives" issues including rational development that were completely absent in their original list. This tends to focus issue on future development while ratepayer concerns are much broader as described above. As such, we believe the issues as articulated in the Ratepayer List provide the Board with the opportunity to consider the potential impacts of a merger on elements of the natural gas market within its legislated authority and jurisdiction.

3) The Public Interest Test requires Definition

The Ratepayer List starts with the question of the appropriate test for the approval of the proposed merger. This is a threshold issue for the determination of a considerable portion of this application. Notwithstanding the applicant's views on fairness[2], the determination of the appropriate test is not that of the applicant's in the way that the evidence is framed but it is that of the Board's discretion. As such, we respectfully submit that it is an issue worthy of submissions and Board determination.

Whatever test the Board determines to be appropriate, we urge the Board to ensure that the test is defined beyond generic labels. Noted lawyer, author and expert witness in these matters, Scott *Hempling puts it succinctly*[3]*:*

> *When I urge utility commissions to create a merger policy, I get one of two responses: "We have no merger pending, so we don't care about it," or "We have a merger pending, so we can't talk about it." That doesn't leave a lot of alternatives. A better approach comes from a wise commissioner: "The old maxim of 'buy low, sell high' when applied to policy work would read 'Invest in policy development in quiet times when its value is low in order to have it available in active times when its value is high.'"*
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> *A good place to invest is in clearing the confusion over "no harm" vs. "positive benefits": By which standard should mergers be judged? Without definitions, each standard is meaningless; with definitions, both standards are the same: A merger must maximize benefits for the customers.*

[2] Applicant's Argument-in-Chief on the Draft Issues List, page 9, paragraph 32.
[3] Hempling, Scott. "NO HARM" VS."POSITIVE BENEFITS": THE WRONG CONVERSATION ABOUT MERGER STANDARDS, May, 2014 http://www.scotthemplinglaw.com/essays/no-harm-vs-positive-benefits

In this application, there is no issue of harm or benefit as it applies to the merging of the corporate parents of the respective utilities. That has occurred and was, of course, outside the purview of the Board. The issues must be viewed by comparing the proposed merger of the utilities to the status quo and what would happen moving forward if the utilities did not merge.

If there were no merger, each utility would have been in the process of applying for a rebasing of their respective rates for 2019. EGD's costs and resulting rates may have required less adjustment due to the nature of their Custom IR ratemaking. On the other hand, Union's 2013 rates were based on costs initially forecast in 2011 with some updates in 2012 since their rates have been de-coupled form costs in their IR regime. While we accept that the rebased utility specific costs could put either upward or downward pressure on rates, we do know that we would expect the move to one corporate parent and the sharing of corporate resources would likely have the effect of reducing the overhead costs of either or likely both utilities. We are not at this point advocating that that evidence must be provided in this proceeding to make determinations on the public interest test. We are merely submitting that this situation of two utilities operated by one corporate parent is the comparison status quo for consideration of the alternative to the proposed merger.

As opposed to drawing perspectives from the previously referenced Hempling essay to try to buttress our position on the need for definition, we thought it would be more effective to draw on the Ontario Energy Board case that the applicant referenced as an example of the Board applying the "No Harm" test[4]. The determinations made by the Board in the proposed sale of a pipeline to the parent company contain some important detail that reinforces our concerns regarding definition of the test. The reasons clarify the Board's view of "No Harm" with specific definition[5]

> *The Board does not see any reason to depart from the no harm test, but notes that in any particular case, the determination by the Board of whether there is harm requires a comparison of the effect of the proposed transaction to the status quo.*
>
> *Keeping these factors in mind, the Board has considered the following questions:*
> *• Would there be benefits as a result of the asset sale?*
> *• Would there be harm to the integrity, reliability, and operational flexibility of Union's system?*
> *• Would there be harm to potential future distribution customers seeking connection to Union?*
> *• Would there be harm to Ontario's gas market as a result of the sale?*
> *• Would there be harm to landowners?*
> *• Would there be harm to ratepayers as a result of the asset sale?*

[4] Applicant's Argument-in-Chief on the Draft Issues List, page 7, paragraph 28.
[5] EB-2008-0411 Decision with Reasons dated November 27, 2009, paragraphs 54, 55 and 91.

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> *Under the status quo, ratepayers would have expected benefits if the capacity expansion project were done as part of Union's regulated business, as has always been contemplated when market conditions permit. At a minimum, the subsidy would have been recouped and quite possibly there would have been a net contribution to rates. There would also be the potential for Transactional Services-type sharing of revenues if there were opportunities to earn additional revenues on a short-term basis. The Board agrees that this is an important aspect of the status quo. Ratepayers will receive no financial benefit from the ongoing business if it is not part of Union's regulated business.*

In the above decision and the subsequent deliberations, the Board rendered a decision that provided ratepayers with the opportunity to receive many multiples of what the applicant had proposed as appropriate compensation to achieve "No Harm".[6]

We believe this type of definition of the tests would contribute to the effectiveness of the proceeding and would again ensure all aspects of the public interest test are considered. In our view, this type of definition of the respective tests provides significantly more value in determination as compared to issues such as[7]:

> *Have the Applicants identified an Earnings Sharing Mechanism (ESM) in accordance with the OEB's 2015 Report – Rate-Making Associated with Distributor Consolidation and the OEB's 2016 Handbook to Electricity Distributor and Transmitter Consolidations?*

Considering the importance of these definitions in the context of this proceeding, it became apparent that any test of financial consequence to ratepayers whether it be "No Harm" or "Net Benefit" becomes very difficult without an understanding of the rate framework to be applied. We understand that the Merger proceeding and Rate Framework proceeding are separate. However, in our respectful submission, we are concerned with our ability to argue for or against certain aspects of the impact of the merger without an understanding of the rate framework that will be applied. For example: Are the interests of consumers sufficiently protected depends upon the imposed rate framework regime.

[6] EB-2008-0411 Decision with Reasons dated May 11, 2010
[7] Applicant's Argument-in-Chief on the Draft Issues List, Attachment 2, page 1, Issue 3.

CONCLUSION

We have limited our submissions to the key areas outlined above. We have done so intentionally with the understanding that our colleagues representing other ratepayers' interests will be submitting other areas of concerns and some will be addressing each specific issue more directly. We have appreciated the collaboration of these colleagues and believe our collective efforts have been well coordinated to reduce duplication while ensuring that the Board is hearing a strong voice from the ratepayers of Ontario on the draft issues lists.

In our above submissions, we have outlined our concerns regarding applicability of the MAAD's policy, issues that cry out for a comprehensive review and the need for definition of the public interest test. We have strived to keep our submissions at a high level so as not to argue the issue only its inclusion on the list. With discovery, the intricacies and complexities of the inter-relationships of combining utilities operations can be seen in a more comprehensive fashion allowing the Board to make decisions on the importance of these issues on ratepayer impacts and potential conditions applied to mitigate ratepayer risk. In our respectful submission, our submissions and those of our colleagues strongly weigh in favour of the more informed assessment of this transaction on the public interest of Ontario.

ALL OF WHICH IS RESPECTFULLY SUBMITTED ON BEHALF OF FRPO,

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