EB-2017-0306

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an Application by Enbridge Gas Distribution Inc. and Union Gas Limited, pursuant to section 43(1) of the *Ontario Energy Board Act, 1998*, for an order or orders granting leave to amalgamate as of January 1, 2019.

Energy Probe Research Foundation
EB-2017-0306
ISSUES LIST COMMENTS

January 26, 2018

In this proceeding, EB-2017-0306, Enbridge Gas Distribution Inc. ("EGD") and Union Gas Limited ("Union") have applied under subsection 43(1) of the *Ontario Energy Board Act, 1998* (the "OEB Act") for leave to amalgamate and to operate as a new gas transmission, storage and distribution company ("Amalco").

In a separate Application, EB-2017-0307, the utilities have applied for a post-amalgamation Rate Setting Mechanism commencing in 2019. A number of issues in these applications are linked, but the Board has determined it will not combine the applications.

DRAFT ISSUES LIST

Certain intervenors filed a draft issues list on January 17, 2018 (Appendix A). The applicants have filed an proposed issues list, as revised on January 19, 2018 (Appendix B).

As indicated in the cover letter, Energy Probe supports the draft intervenor proposed issues list filed by Mr. Mondrow on behalf of IGUA and the 14 intervenors (attached as Appendix A)

Energy Probe believes it more appropriately reflects the issues in this case than the proposed revised issues list of Enbridge and Union Gas ("the utilities").

The reasons for this relate to the specific context and features of the proposed merger, notably:

- Enbridge Gas Distribution Inc. and Union Gas Limited are Ontario's largest natural gas transmission companies (along with federally-regulated TransCanada Pipelines); own and operate all of Ontario's gas storage and are the major gas distribution companies, serving 2.5 million customers across the province.
- Both gas companies are now owned by Enbridge Inc.
- The amalgamation will result in a major structural change to the province's natural gas sector, transforming the entire sector -- including distribution, transmission and storage -- into a monopoly service.
- There is no government policy, or other imperative, for the companies to amalgamate -- they are merging for business reasons alone.

TEST FOR APPROVAL OF THE MERGER

It is not appropriate in this case to frame the issues list on the paradigm of the electricity distribution sector Mergers Acquisitions and Amalgamation for Distributors guidelines (per MAADs Consolidation Handbook). That Handbook was designed to encourage consolidation among the province's hundreds of local distributors and ensure ratepayers weren't harmed in the process. It was not crafted with the amalgamation of the province's two largest gas utilities in mind, which together will control nearly the entire gas sector in Ontario. The consolidation policy among electricity distributors was

encouraged by the province -- it was highlighted in both its 2013 and 2017 Long-Term Energy Plans (LTEPs) -- and no such government directive has been established for the gas utilities.

Furthermore, the MADDs policy didn't consider the impact of amalgamating the storage and transportation assets of the province's two major gas utilities and the impact this may have consumers and the economic efficiency of the gas sector. Comparing consolidation in the LDC sector and the gas sector is materially different, both due to the difference in number of utilities -- hundreds in the case of LDCs, although that number has been whittled down to dozens -- and the ownership of storage and transmission assets. Apart from Hydro One, which operates its transmission and distribution businesses separately, no LDC has the kind of market power over the entire electricity market that the combined gas utilities will possess once they complete the amalgamation.

At the heart of the MADDs Handbook is that the Board should perform the regulatory "no-harm" test when approving consolidations among Ontario's LDCs. The utilities have adopted this position in their application.

Energy Probe's position is that it is not necessary for the Board to indicate via the issues list what tests or criteria it may employ in order to approve the amalgamation in advance of the hearing. Nor should it limit the test to "price" and quality of service, as the utilities proposed in their revised issues list. The issues list should remain broad, given the broad scope of the amalgamation and the lengthy timeline for the benefits to accrue to customers in the form of lower utility costs and the proposal to set rates to 2029.

The issues list proposed by the gas utilities explicitly defines what test the Board should use -- the "no harm" test -- in determining whether the merger should be approved. The utilities' issues list, in short, says it *is* the no harm test, as they define it that the Board should consider and nothing else and the reason for doing so is that is the policy framework established in the MADDs Handbook.

Energy Probe suggests that even if the appropriate test was "no harm", this can be interpreted narrowly, for example, by focusing only on price and quality of service, or more broadly to include maintenance of a viable transmission and storage system. In short, even within the narrow bounds of approval presented by the utilities in their issues list, the potential merits of the merger are vast and should be explored thoroughly. Constraining that debate through a preliminary determination that the "no-harm" test alone and not the "net benefit" or other tests, is the ideal threshold that the utilities must meet would be counterproductive, in our view.

While the gas utilities argue that their proposed issues list is in line with the MADDs guidelines and, as such, should be the basis from which the application should be viewed, Energy Probe, as highlighted above, hopes the Board won't limit the review of this merger by using guidelines designed for an electricity sector, which is materially

different than Ontario's gas sector. The Board has never reviewed an amalgamation of this magnitude, which will leave Ontario with, essentially, one gas company in control of all distribution, transmission and storage gas assets. Energy Probe sees no benefit to limiting the scope of this hearing, given the impact this merger will have on Ontario's natural gas sector. Shoe-horning a policy designed for an electricity distribution sector that is materially different than that of the gas sector would limit a thorough investigation of the benefits of the merger for Ontario gas customers.

The Board may also want to consider how other regulators in North America have dealt with utility merger applications of this scale.

Over the last decade regulators in the United States have applied varying degrees of the "public interest", "no-harm" and "net benefit" policy to mergers among large utilities. In Massachusetts, for example, in the run-up to a merger between two large utilities, the regulator changed its merger policy from one of "no-harm" to one of "net benefit". In other mergers -- Entergy Mississippi, Inc. and ITC Holdings Corp. (ITC); Exelon Corporation and Pepco Holdings, Inc. (PHI); UIL Holdings Corporation and Iberdrola USA; Hunt Consolidated, Inc. and Oncor; and the decision by Macquarie Infrastructure and Real Assets, British Columbia Investment Management Corporation, and John Hancock Financial to purchase Cleco Corporation -- regulators have either approved or required the merging utilities to agree to provide a number of benefits for ratepayers in order for the merger to receive approval. In every case, the regulators sought to ensure the merger was in the *public interest.*[1]

In Energy Probe's view, the Board should avoid limiting the merits of the amalgamation simply to the "no-harm" test, given the basis for that policy, as explained above, was designed for the province's local distribution sector. Instead, the Board should leave the threshold that the merger must meet to include the "no harm", "net benefit" and "public interest", which has been used by regulators across North America. As discussed later in this argument, the amalgamation of the two utilities entails a ten-year deferral of rebasing, which will significantly cloud the determination of the "no-harm" or "net benefit" threshold and, as such, broadening the threshold to include "public interest" and "net benefit" should be considered and, at the minimum, not be removed from the proceeding all together.

To be clear, Energy Probe isn't arguing that the "no-harm" test should be discarded and replaced with other tests, but rather, that the Board refrain from limiting the scope of the hearing at the outset.

Furthermore, Section 28.01 of the Rules of practice and procedure indicates that issues lists are to assist the Board and the conduct of the parties in a hearing. Leaving the issues broad enables, rather than constricts, this hearing. The Board, in our view, should avoid limiting the test for approval of the merger to one of "no-harm."

[1] https://www.americanbar.org/publications/infrastructure/2015-16/summer/the_evolving_public_interestrecent_decisions_utility_merger_proceedings.html

As such, issues “1”, “2” and “3” on the intervenors’ issues list recognize that the “no-harm” test is one option, but leaves the matter open to input from the parties and for the Board to determine. These issues ask the wider questions -- “what test or tests are appropriate in this case” -- in order to allow the parties to provide complete evidence and submissions to the Board regarding the benefits of the merger.

Ultimately, Energy Probe believes the Board should examine the evidence and approve -- or not approve -- the amalgamation without the constraints of any particular framework or test. The parties should be allowed to provide their input to the Board on what factors or outcomes from the merger should be given appropriate weight, and be able to do so without prior constraints.

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REBASING DEFERRAL

The current rates for each of Enbridge and Union are in the fifth year of a 5-year IRM and have not been reviewed in detail since 2013.

The merger application put forth by the utilities relies on provisions of the MAADs Handbook to support their proposal for a rebasing deferral (or base rate review) for another ten years -- pushing it out to 2029, for a total of 15 years since cost-of-service rebasing in 2013.[2] Energy Probe believes this is inconsistent with the OEB Renewed Regulatory Framework (RRF). Under the RRF, the approved rates for utilities will be just and reasonable only until 2019, at which point they should be reviewed. It’s only as a result of the MADDs application that the re-basing of rates would be deferred.

The applicants cite two recent electricity cases in support of their position that they can choose the ten-year Rebasing Deferral Period.[3] As noted above, Energy Probe is of the view that the policies associated with utility consolidation, as detailed in the Report of the Board, Rate-making Associated with Distributor Consolidation released in March, 2015, and employed in the two cases cited above, were designed to explicitly encourage consolidation in the electricity sector, not the gas sector. The gas utilities’ argument that the Board’s current policy for allowing a rebasing deferral period of ten years should not be accepted in this proceeding at the outset.

Furthermore, Energy Probe is of the view that the RRF stipulates that utilities must rebase every five years. If the utilities’ amalgamation proposal is accepted in its current form, rebasing won’t occur for 15 years, which is well beyond any timeline associated with the RRF. Therefore, under the approved 5-year IRM plans there is no option except to apply under section 36 of the Act for approval for continuing the existing rates, or for new rates for 2019. Amalgamation of the two utilities does not change this requirement.

[2] Consolidation Handbook, page 12

[3] EB-2016-0025, Decision and Order and EB-2016-0050, Decision and Order,

To be clear, Energy Probe's concern relates to setting 2019 base rates, not to how rates should be set post-amalgamation, or how long Amalco may defer rate changes post-amalgamation. Energy Probe accepts that Amalco requires a period post-amalgamation in which to recover transactional and transitional costs and be allowed to maintain approved rates during that period.

Energy Probe understands that the rate setting application EB-2017-0306 deals specifically with how to set rates for 2019 and beyond. But what is relevant to this application is whether a ten-year deferral for rebasing is appropriate. Energy Probe believes this issue is as important an issue in the amalgamation application as the determination of what test -- "no-harm", "net-benefit" or a broad "public interest" -- should be used to approve or deny the amalgamation.

The intervenors have raised this issue by asking that specific question and two consequential questions -- Issues "4", "5", and "6" on their proposed issues list.

COST ALLOCATION

The issue of cost allocation must also be included in the application to amalgamate.

If rebasing were deferred, both the revenue requirement and the allocation of the revenue requirement to transmission, storage and distribution services, as well as cost allocation to rate classes, may not be reflective of costs to serve and may result in rates that are not just and reasonable. This is contrary to the outcomes expected in the RRF. For example, there are specific cost allocation changes resulting from Union's infrastructure expansion during the 2014-2018 IRM term that have been deferred until rebasing.[4] It's unclear how those cost allocation changes will be dealt with if the Board approves a ten-year rebasing deferral, as is currently being proposed.

Cost allocation is another reason that the utilities may be required to rebase in 2019, prior to entering into the post-amalgamation Rate Setting Mechanism.

IMPACTS OF THE MERGER

As noted earlier, the proposed merger/amalgamation may produce major structural changes to Ontario's natural gas sector and to the regulation of that sector. The scale and scope of the changes, particularly in transmission and storage, may not be fully understood until post-amalgamation.

Energy Probe supports these potential impacts being on the issues list and considered during the hearing. This may facilitate a process for review of potential impacts and/or conditions of approval. If additional evidence is available, the interrogatory process can put this on the record.

UNDERTAKINGS

[4] EB-2017-0087 Union Gas Limited Decision and Order page 8, January 18 2018

The Undertakings of the Companies to the Lieutenant General In Council are set out in the evidence. The appropriate disposition of these Undertakings post-amalgamation should also be on the issues list, as proposed by the intervenors.

Submitted on Behalf of Energy Research Foundation

Brady Yauch, consultant to Energy Probe, MA and MSc

Dr. Roger Higgin, consultant to Energy Probe

Appendix A Intervenors proposed Issues List

EB-2017-0306
Enbridge Gas Distribution Inc. and Union Gas Limited
Application for approval to amalgamate Enbridge Gas Distribution Inc. and Union Gas Limited
PROPOSED ISSUES LIST

[Bold & italicized numbers reference utilities' proposed issues list.]

TEST FOR APPROVAL OF THE MERGER

1. What is the appropriate test for approval of the merger under section 43(1)(c) of the Ontario Energy Board Act, 1998; "no harm", "net benefits", other?

2. How should the test for approval be applied in this case, including in consideration of the Board's statutory objectives in relation to gas? ***[Utilities Issues 1, 5, 6, 7 and 8]***

3. Have the applicants met the appropriate test?

REBASING DEFERRAL

4. Is deferral of rebasing appropriate in the context of this application?

5. If so:
(a) What is the appropriate deferral period?
(b) Is an earnings sharing mechanism [ESM] appropriate and if so what should that mechanism be and when should it apply? ***[Utilities Issues 3 & 4]***
(c) What additional considerations and requirements are appropriate to protect the interests of customers pending rebasing?

6. What commitments to future action have the utilities made during their respective 2013-2018 rate plan terms, what other rate setting issues merit attention now (including cost allocation issues), and when and how are these commitments and issues to be addressed?

IMPACTS OF THE MERGER

7. Would the proposed merger impact any other OEB policies, rules or orders (e.g. regulation of new storage, Storage and Transmission Access Rule (STAR))? If so, what are those impacts and how should the Board address them?

8. If leave is granted, what conditions should be attached?

9. What is the status of the Undertakings to the Lieutenant Governor in Council of Ontario?

10. Should the undertakings be replaced by a condition of the approval of the OEB of the proposed merger?

11. If so, what should the content of the condition be?

Appendix B: Companies' Revised Issues List

ENBRIDGE GAS DISTRIBUTION INC. AND UNION GAS LIMITED
MAAD APPLICATION
REVISED DRAFT ISSUES LIST

PRICE, COST EFFECTIVENESS AND ECONOMIC EFFICIENCY:

1. Does the proposed consolidation protect the interests of consumers with respect to price?

2. Have the Applicants clearly identified the specific number of years for which they have chosen to defer the rebasing?

3. 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?

4. Does the ESM, as defined in the application, achieve the objective of protecting customer interests during the deferred rebasing period?

RELIABILITY AND QUALITY OF GAS SERVICE:

5. Does the proposed consolidation protect the interests of consumers with respect to adequacy, reliability, and quality of gas service?

FINANCIAL VIABILITY:

6. Does the proposed consolidation maintain the financial viability of the consolidated entity in the delivery of the ongoing investment and maintenance of the distribution system?

7. What is the effect of the consolidation on the cost structures of the consolidating distributors?

8. What is the impact of the financing of incremental costs (transaction and integration costs) on the consolidating entities