



ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION

**Enbridge Gas Distribution Inc. and Union Gas Limited
Rate-Setting Mechanism Application
EB-2017-0307**

February 2, 2018

1. Background

Enbridge Gas Distribution Inc. (Enbridge Gas) and Union Gas Limited (Union Gas), jointly referred to as the applicants, filed an application dated November 23, 2017 with the Ontario Energy Board (OEB) under section 36 of the *Ontario Energy Board Act, 1998*, for approval of a rate setting mechanism and associated parameters, effective January 1, 2019. The applicants have requested the rate setting framework for a period of 10 years ending in December 2028.

Enbridge Gas and Union Gas are currently operating under multi-year incentive rate frameworks that expire at the end of 2018. Enbridge Gas currently operates under a five-year Custom Incentive Rate-setting (IR) framework approved by the OEB on July 17, 2014¹. Union Gas is currently operating under a five-year price cap Incentive Rate-setting Mechanism (IRM) approved by the OEB on October 7, 2013². On November 2, 2017, Union Gas and Enbridge Gas filed an application³ to amalgamate into a single company (the amalgamation application). In the absence of amalgamation, Enbridge Gas and Union Gas would be required to apply for rebasing for 2019 rates.

The applicants in their evidence included a draft issues list for the consideration of the OEB. Pursuant to Procedural Order No. 1, an Issues Conference was held on January 22, 2018, with the objective of developing a proposed issues list for presentation to the OEB. However, there was no consensus on the issues list proposed by the applicants.

By letter dated January 23, 2017, the Industrial Gas Users Association on behalf of a number of intervenors submitted an alternative issues list. The applicants filed their argument-in-chief on January 26, 2018, with a revised draft issues list upon consideration of the alternative issues list filed by the intervenors.

2. Summary

The main difference between the applicants' proposed issues list and the intervenors' alternative list is that the applicants presuppose that the OEB's established framework for evaluating mergers, acquisitions, amalgamations and divestitures (MAADs) in the electricity sector applies equally to MAADs in the gas sector. In particular, the applicants maintain that the OEB should only consider price cap as the rate-setting approach

¹ EB-2012-0459

² EB-2013-0202

³ EB-2017-0306

during the deferred rebasing period. The applicants in their argument-in-chief refer to the MAADs Handbook⁴ which notes that from the time of expiry of the term of each utility's existing plan to the end of the deferred rebasing period, Price Cap IR will be the rate-making model for each of the consolidating distributors⁵. The intervenors, on the other hand, prefer the ability to engage in a broader examination of the appropriate ratemaking framework that should be implemented during the deferral period, if a deferral period is approved by the OEB in the companion MAADs proceeding⁶.

In its submission on the issues list for the amalgamation application,⁷ OEB staff has already presented its views on whether the OEB's MAADs Handbook must be applied as argued by the applicants.

OEB staff submits that the issues list should not restrict the ability of the parties to argue for a rate-setting approach that is different from the one proposed by the applicants. Accordingly, the alternative issues list proposed by the intervenors is an appropriate starting point. However, OEB staff is concerned that the issue regarding the rate-setting approach during the deferral period (Issue #1) as described by the intervenors may be too broad and would allow parties to argue for almost any rate-setting approach.

The OEB's *Handbook for Utility Rate Applications*⁸ (Rate Handbook) notes that natural gas utilities may propose either Custom IR or Price Cap IR when filing a rate application. This is reiterated in the *Filing Requirements for Natural Gas Rate Applications*⁹ which states, "Going forward, there will be two rate-setting policies available for natural gas utilities: Price Cap Incentive Rate-setting (Price Cap IR) and Custom Incentive Rate-setting (Custom IR)." However, these options are discussed in the context of a rate application in the normal course. In a merger situation where a deferral period has been approved, it would defeat the purpose of the deferral period to allow the merged utility to file a cost based application before the end of the deferral period, subject to any approved off-ramps.

This leads to the conclusion that the Price Cap IR mechanism (or another comparable incentive rate-setting mechanism that does not involve a full review of costs) is the one that should apply, if the OEB approves a deferral period in the MAADs proceeding. In OEB staff's view, the features and parameters of the mechanism could deviate from the

⁴ Handbook to Electricity Distributor and Transmitter Consolidations, January 19, 2016

⁵ Handbook to Electricity Distributor and Transmitter Consolidations, pages 13-14

⁶ Eb-2017-0306

⁷ OEB Staff Submission, EB-2017-0306, January 26, 2018

⁸ October 13, 2016

⁹ February 16, 2017

exact mechanism used in electricity and therefore the details of such a mechanism, such as how to calculate and apply the productivity factor, whether a stretch factor should apply, how to apply and calculate an earnings sharing mechanism, etc., are valid issues to be determined in this proceeding.

3. Staff Submission

The purpose of an issues list

As OEB staff noted in its submission on the issues list on the amalgamation application, the issues list serves to scope the parameters of the hearing. It establishes the matters that can be considered by the OEB in making its ultimate decision. In effect it sets out the broad questions that are at issue in the proceeding. It does not serve to provide “answers” to any of those questions, it simply sets out the matters that parties are permitted to discuss as part of the hearing. Issues should only be excluded from the issues list, therefore, if the panel is certain that the matter has no relevance to the proceeding.

Issues proposed by the intervenors

OEB staff generally supports using the alternative issues list proposed by the intervenors as a starting point. A number of issues on the intervenor issues list have been reworded from the draft issues list submitted by the applicants. However, there are certain issues that the applicants disagree on and these are mainly related to the parameters stated in the MAADs Handbook. OEB staff adds the following comments on issues that it disagrees with or has suggested revisions to them as drafted by the intervenors.

Issue #1 - If the Board grants the Applicants’ request for approval of a merger and deferral of rate rebasing, what rate making framework (the “Framework”) should be used to set rates during the deferral period? (An IRM formula, a Custom IR plan, or another rate setting mechanism?)

Proposed rewording:

If the OEB grants the Applicants’ request for approval of the merger and deferral of rebasing, what should be the features of a Price Cap IR mechanism during the deferral period?

As noted above, OEB staff notes that the Custom IR is a cost-based application that is akin to rebasing as noted in the Rate Handbook¹⁰. OEB staff notes that the applicants have prepared their evidence on the basis of a Price Cap IR mechanism. As this issue is premised on a deferral period being granted in the companion MAADs proceeding, a Custom IR application is, in OEB staff's view, not available to the applicants as it would defeat the purpose of a deferral period, regardless of length of term.

Issue 3 (a) – Should it be a rate cap or a revenue cap?

Subject to staff's comments on the status of the Custom IR option as noted above, the Price Cap IR is the other multi-year rate-setting approach contemplated by the OEB for natural gas distributors. The reference to Revenue Cap for electricity transmitters is intended to convey that the rate adjustments made under an incentive rate-setting period for transmitters are made to revenue requirement and not individual transmitters' rates, given that none exist¹¹. The Rate Handbook with respect to electricity transmitters states that the Revenue Cap IR methodology is similar to the Price Cap IR option discussed for distributors¹². That said, and as noted earlier in this submission, if an alternative incentive rate-setting mechanism that does not involve rebasing is consistent with the spirit and intent of the OEB's current Price Cap IR methodology, then there is no reason in OEB's staff view why this cannot be examined. Accordingly, staff does not oppose this issue but recommends recasting it as Issue #1(b) as follows:

Is there another incentive rate-setting mechanism that may be more appropriate for the deferral period? If so, what should be its features?

Issue 3

If the OEB prefers to set out the individual components of an incentive rate-setting method as discreet issues on the Issues List, OEB staff submits the following change to Issues 3(d) and 3 (h).

Issue 3 (d) – Should there be a productivity stretch expectation and if so what should it be?

¹⁰ Handbook for Utility Rate Applications, page 23, footnote 15

¹¹ The OEB uses a pooling mechanism for transmission rate recovery that underpins Uniform Transmission Rates

¹² Handbook for Utility Rate Application, page 24

OEB staff submits that the stretch factor is a separate component of the Price Cap mechanism and accordingly proposes the following change:

Should a stretch factor apply and if so, what is the appropriate stretch factor?

Issue 3 (h) – Should capital module (ICM & ACM) mechanisms be available, and if so, under what parameters?

OEB staff does not agree with the intervenors' suggestion that a capital module mechanism may not be available to the applicants under a Price Cap IR rate-setting mechanism. OEB staff notes that the Advanced Capital Module (ACM) would not be available to the applicants as an ACM proposal is made during a cost of service application. However, an Incremental Capital Module (ICM) is available to all utilities during an incentive regulation period as per the Rate Handbook. The issue in the case of an ICM would be the construct for such matters as the materiality threshold and the criteria that are adopted to qualify for recovery of capital investments. Accordingly, OEB staff proposes:

Is the proposal for calculating the cost recovery treatment of qualifying capital investments consistent with the OEB's policy for Incremental Capital Modules, and if not are any deviations appropriate?

Is the proposal to include variances with respect to the following appropriate?

- *Separate materiality threshold calculations using rate base and depreciation as last approved by the OEB for each of Enbridge Gas Distribution Inc. and Union Gas Limited*
- *Using updated cost of capital parameters to calculate the incremental revenue requirement for funding capital investments?*

Issue #4 – Are there determinations requested in the merger approval application which will have to be reconsidered in light of the Board's determinations on the appropriate rate framework to be applied post-merger (e.g. deferral period, earnings sharing parameters, other), and how should the Board address these in its determinations on each of the two applications?

OEB staff does not agree that this issue is required. The interdependencies between the two applications are already known and it is improbable that the

rate-setting framework application will not consider the determinations of the merger application.

Issue #7

What are the implications of the merger for gas supply planning and costing and how will those impact cost allocation and rates?

OEB staff submits that this issue should not be included on the approved issues list.

OEB staff notes that the OEB has initiated a process to establish a framework for the assessment of the gas supply plans of Enbridge Gas and Union Gas.¹³ It is a separate initiative that will also address the level and type of process that will be used to review the plans.

As far as the impact of the gas supply plan on cost allocation and rates is concerned, it is assumed that this refers to the gas supply plan that will be prepared by the applicants after a merger has been approved and a gas supply planning framework has been determined by the OEB. OEB staff submits that the timing of such changes may not align with the current proceeding and (subject to the outcome of the rate framework proceeding) could be dealt with in a future annual rate adjustment application.

OEB staff notes that there is already a placeholder on the intervenors' Issues List with respect to cost allocation. Changes in cost allocation and rate design have been captured in Issue #5. To the extent that a matter arises out of the gas supply planning framework initiative that can be addressed in a timely manner as part of the rate framework proceeding, it can be examined under Issue #5 which is described below.

What changes to rates, regulated services, cost allocation or rate design should be permitted or required during the rate plan period and what process should be required for such changes to be made?

Issue B – Setting 2019 Rates

Although OEB staff agrees that a mechanism may be required to set 2019 rates in case the current applications and a future rates application of the amalgamated utility are not reviewed in time to set rates effective January 1, 2019, the proposed wording of the intervenors to address this issue is unnecessarily complicated.

¹³ EB-2017-0129

OEB staff proposes the following wording to describe the issue:

How should rates for 2019 be set if this proceeding is not completed in sufficient time for an application to be filed for rates effective January 1, 2019?

– All of which is respectfully submitted –