



Ontario Energy Board Commission de l'énergie de l'Ontario

DECISION AND ORDER

EB-2016-0137

EB-2016-0138

EB-2016-0139

SOUTH BRUCE EXPANSION APPLICATIONS

Applications to serve the Municipality of Arran-Elderslie, the Municipality of Kincardine and the Township of Huron-Kinloss with natural gas distribution services

BEFORE: Ken Quesnelle
Presiding Member

Cathy Spoel
Member

Paul Pastirik
Member

April 12, 2018

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1 INTRODUCTION AND SUMMARY

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*, seeking approval for its franchise agreements with, and certificate of public convenience and necessity (certificate) for, the Municipality of Arran-Elderslie, Municipality of Kincardine and the Township of Huron-Kinloss.

The OEB had announced previously on January 20, 2016 that it would be holding a generic proceeding to review opportunities for natural gas expansion in the province (Generic Proceeding on Community Expansion).¹ The OEB issued its decision on natural gas expansion on November 17, 2016 (Generic Decision). In that decision, the OEB set out its policy intended to encourage competition in the provision of natural gas distribution service in presently unserved communities. The EPCOR applications are the first set of applications with which the OEB is implementing this policy. Consistent with this policy on competition, the OEB invited other potential providers of natural gas distribution service to notify the OEB of their interest in serving the South Bruce communities. Union Gas Limited (Union Gas) filed a letter dated January 19, 2017, notifying the OEB of its interest. In recognition of the equal status of both utilities as proponents in the competition, the proceeding was renamed the South Bruce Expansion Applications, and the style of cause changed accordingly.

The OEB decided to assess the competing applications through a two-phase process. In the first phase, the OEB would consider submissions on certain preliminary issues, and in the second phase, the OEB would select either EPCOR or Union Gas as the successful proponent.

To facilitate the selection of a successful proponent to serve the South Bruce Municipalities, the OEB established a Common Infrastructure Plan (CIP), which would serve as a relative proxy to allow the OEB to undertake a comparison of the proponents' stated revenue requirements on a set of common parameters.

This decision provides the OEB's findings on the second phase of this proceeding. The OEB has considered the numerous selection criteria submitted in the CIP proposals and determined that the cumulative 10-year revenue requirement per unit of volume (\$/m³) is the criteria that best addresses the OEB-stated objectives regarding the introduction of competition in the natural gas service expansion into new service areas. Given EPCOR's lower cumulative 10-year revenue requirement per m³ (\$0.2209/m³ versus

¹ EB-2016-0004

0.2444/ m³ for Union), which EPCOR has committed to maintaining for the duration of the 10-year rate stability period, EPCOR is granted certificates of public convenience and necessity for each of the Municipality of Arran-Elderslie (except for the geographic area of the former Township of Arran and the former Village of Tara), the Municipality of Kincardine and the Township of Huron-Kinloss, conditional on the approval of its subsequent leave to construct application.

2 THE PROCESS

A Notice of Hearing was issued on December 21, 2016 and was served on all parties in EB-2016-0004. 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 filed a letter dated January 19, 2017 notifying the OEB of its interest in serving the areas covered by the South Bruce Expansion Applications.

Through procedural orders, the OEB determined that it would hear the applications to serve the areas in two phases. In the first phase, the OEB would consider submissions on certain preliminary issues, and in the second phase, the OEB would select either EPCOR or Union Gas as the successful proponent.

On June 23, 2017, the OEB issued a Partial Decision and Procedural Order No. 6 (the Partial Decision), which addressed two of the issues on the Preliminary Issues List, and which also required both EPCOR and Union Gas to participate in a joint session with OEB staff on July 13, 2017 to determine the technical parameters of a Common Infrastructure Plan (CIP) for the area covered by the South Bruce Expansion Applications.

On July 20, 2017, OEB staff submitted a progress report which outlined the CIP parameters discussed in the joint session, areas of agreement and disagreement between proponents, draft permissible rate adjustment criteria and proposal comparison criteria. The proponents requested that the OEB allow for submissions on the areas of disagreement.

On August 2, 2017, pursuant to Procedural Order No. 7, the OEB heard oral submissions from EPCOR and Union Gas regarding each of the areas of disagreement listed in OEB staff's progress report and their proposed process for moving forward with this proceeding.

On August 22, the OEB issued a Decision on Preliminary Issues and Procedural Order No. 8 (the Decision and P.O. 8), which resolved the CIP-related issues that were the subject of the August 2, 2017 oral hearing, and addressed those other aspects of the Preliminary Issues List that were not determined in the June 23, 2017 Partial Decision.

In accordance with the Decision and P.O. 8, EPCOR and Union Gas each filed their proposals for serving the area covered by the South Bruce Expansion Applications on October 16, 2017.

In Procedural Order No. 9 (P.O. 9), which was issued on December 7, 2017, the OEB determined that it would be assisted by limited interrogatories to clarify certain aspects of the proposals, and invited parties to submit any other interrogatories that parties believed to be absolutely necessary in assisting the OEB in its deliberations. In P.O. 9, the OEB also made provision for a round of submissions from all parties, to be filed on January 25, 2018. The OEB issued a final list of interrogatories for both EPCOR and Union Gas on December 22, 2017.

On January 19, 2018, the OEB issued a summary table of metrics and CIP criteria based on EPCOR and Union Gas' CIP proposals and interrogatory responses, to ensure that parties had a common understanding of the proposals prior to filing their submissions. On January 22, 2018, EPCOR filed a letter in response to the OEB's table, identifying inaccuracies and proposing several corrections to the summary table.

In Procedural Order No. 10, which was issued on February 22, 2018, after reviewing submissions from all parties, the OEB determined that EPCOR should be allowed to provide explanations for potential anomalies identified by parties in EPCOR's submissions and interrogatory responses.

On March 2, 2018, EPCOR filed its response to the OEB's questions.

3 THE CIP PROPOSALS

This section provides a brief comparison of the two CIP proposals. A comparison summary table can be found below.

3.1 Revenue Requirement

EPCOR's stated cumulative 10-year revenue requirement as calculated over a 120-month period was \$75.6 million, with a net present value of \$59.1 million. Union Gas' stated cumulative 10-year revenue requirement over the same period was \$70.1 million, with a net present value of \$55.4 million.

3.2 Customer Attachment and Volume Forecast

Union Gas' total customer years, defined as the cumulative number of customers connected over the 10-year rate stability period multiplied by the number of years each customer is connected, was 54,171. EPCOR's total customer years was 42,569.

In terms of cumulative volume, defined as the cumulative volume of throughput per year, over the ten-year rate stability period, EPCOR's cumulative volume was 342 million m³. Union Gas' cumulative volume was 287 million m³. These cumulative volumes take into account the Normalized Annual Consumption (NAC) of each proponent's industrial customers.

Union Gas' cumulative 10-year revenue requirement per m³ was \$0.2444/m³ while EPCOR's was \$0.2209/m³.

3.3 Route and Infrastructure Plan

EPCOR proposed a single continuous system to serve the South Bruce municipalities, taking service from Union's Owen Sound Line at Dornoch, while Union Gas' proposal involves two segments, with one supply lateral tied to the Owen Sound Line and the second tied to the Forest-Hensall-Goderich System. EPCOR's total proposed kilometers of pipeline in the first 10 years was 309.9 kilometers, while Union Gas' was 321.7 kilometers.

Both proponents proposed to commence construction in 2019. EPCOR submitted that it expects its Environmental Report process to be completed within six to ten weeks of the certificate award, allowing for an early construction start in the winter of 2019. EPCOR noted that this potential one winter advancement improves the viability of project economics.

Metric / Criteria	EPCOR	Union Gas
Net Present Value (NPV) of 10-year Revenue Requirement	\$59.1 million	\$55.3 million
Cumulative 10-year Revenue Requirement	\$75.6 million	\$70.1 million
Cumulative 10-yr revenue requirement per unit of volume ²	\$0.2209 / m ³	\$0.2444 / m ³
Customer years ³	42,569	54,171
Cumulative 10-yr volume ⁴	342 million m ³	287 million m ³
Total kilometers of pipeline	309.9 km	321.7 km

² The sum of total annual revenue requirement for 10 years divided by the total volumes for 10 years.

³ Based on the number of customers connected multiplied by the number of years each customer is connected during the initial 10-year service period.

⁴ The cumulative volume of throughput per year, over the ten-year rate stability period.

4 OEB DECISION

4.1 Proponent Selection Criteria Determinations in South Bruce Expansion Applications

The Generic Decision established a general framework for competition in the servicing of new communities that do not satisfy the economic tests embodied in the E.B.O. 188 policy.

The framework established in the Generic Decision features:

- ***Stand-alone rates.*** The allowance of stand-alone rates or a system expansion surcharge (not subsidized through rates paid by existing service area customers) that reflect the costs to serve the customers in the newly serviced area. This element facilitates competition by new service provider entrants.
- ***The establishment of a rate stabilization period.*** A rate stabilization period that ensures rates reflect the long-term costs to serve an area as well as ensuring that any risks of revenue deficiency rests with the service provider.
- ***Incentives to lower costs.*** Incentives to build and operate at lowest possible costs in order to attract connections so that stated revenue requirements during the rate stabilization period can be achieved or exceeded.

These features have been put into effect in this case through: 1) a requirement for proponents to base the revenue requirement in their CIP proposals on fully allocated project and OM&A costs, 2) the establishment of a 10-year rate stability period and 3) competition to provide an incentive to lower costs.

The Partial Decision contained the OEB's expressed intention to make a selection determination based on a proponent's commitment to construct and operate a Common Infrastructure Plan for a stated revenue requirement over a 10-year period. Rather than requiring proponents to submit full leave to construct applications which would make it difficult to assess the value of each proponent's proposal, the establishment of the CIP was meant to serve as a proxy to allow the OEB to compare revenue requirements on a set of common parameters.

The Decision and P.O. 8 accepted numerous parameters to be used by the OEB in its consideration of the proposals that the proponents had agreed to in a joint session with OEB staff. The OEB accepted the following agreed-upon parameters:

- **Communities to be Served:** Proponents are required to provide service to the following communities: Chesley, Inverhuron, Paisley, Tiverton, Kincardine, Lucknow, Lurgan Beach, Point Clark, Ripley and the Bruce Energy Centre Industrial Park.
- **Comparison Criteria:** The proponents agreed to three comparison criteria to be included in CIP proposals: \$/m³, number of customer years and cumulative 10-year volume.
- **Infrastructure Specifications:** The proponents agreed that infrastructure specifications, such as the size of the pipeline to be built, its routing and resulting costs, would be left to competition. However, proponents were expected to include details of the infrastructure, including the routing and engineering, in their proposals.
- **Construction Schedule:** Gas mains to all the communities to be served are to be constructed within two years from the commencement of construction. The timing of customer connections each year during the rate stability period, however, would be left to competition. Proponents were expected to include their construction schedule forecast in their proposals.
- **Customer Attachments:** The number of attachments were to remain competitive and based on the levels of risk and marketing activities that each proponent would be willing to take on. Proponents were expected to include details on their forecast attachments as part of the proposals, with the successful proponent to be held to its forecast for rate-making purposes.
- **10-year Forecast Horizon:** Proponents were to use a 10-year horizon for customer attachment and volume forecasts.
- **Customer Consumption:** Proponents were to use common consumption levels for each mass market segment, except for large commercial or industrial customers, which were to be left to competition.

- **Depreciation Rates:** Proponents were to use depreciation rates based on Union's OEB-approved depreciation rates.
- **Capital Structure:** The capital structure for both proposals were to be based on Union's approved deemed debt/equity ratio of 64% / 36%. However, the cost of debt and return on equity (ROE) were considered competitive. The OEB also found that it would not hold Union to its existing debt rates or return on equity applied to its regulated business.
- **Government Grants and Municipal Contributions and Aid to Construction:** Both proponents were to use a gross revenue requirement excluding any government grants, municipal contributions and Aids to Construction.
- **Demand-Side Management (DSM) Costs:** Both proponents were to exclude DSM costs in their proposals.
- **Cap and Trade Costs:** Both proponents were to exclude Cap and Trade costs in their proposals.
- **Taxes:** Both proponents were to use common tax rates and exclude any tax holidays from the municipality from their proposals.
- **Service Levels:** Both proponents were to plan for operations and maintenance that would meet the service levels identified in the Gas Distribution Access Rules (GDAR).
- **Gas Commodity Costs:** Both proponents were to exclude gas commodity costs from the revenue requirement proposal.
- **Interest During Construction (IDC):** Both proponents were to use the OEB-prescribed rate for IDC, so that it will be common between proposals.
- **"Other" or "Intangible" Category:** Both proponents were to include an "Other" or "Intangible" category in their proposals that would include other non-financial issues that the OEB could take into account in its decision.
- **Upstream Reinforcement:** Upstream reinforcement costs were to be excluded from the CIP proposals. The OEB will review these costs and

their underlying assumptions in the rate case following the selection of the successful proponent.

- **Inflation Costs:** For the purposes of establishing the calculation of the 10-year gross revenue requirement, proponents were allowed to apply the rate of inflation to capital and OM&A costs during the rate stability period, with the same inflation rate (Union's suggested common inflation rate, which should be equivalent to the estimated long term inflation rate based on the most recent four quarter average GDP IPI FDD methodology accepted by the OEB) applied to both proposals.
- **OM&A Costing Methodology:** The OEB reaffirmed the principle of fully allocated costs as set out in the Generic Decision, which prevents cross-subsidization of new expansion customers by current ratepayers. Proponents were expected to base their OM&A cost estimates on an allocation that would result from a fully allocated cost study typically filed in a full rates case. However, the OEB did not expect a full cost allocation study to be filed in proponents' proposals.
- **Treatment of Capital Costs:** Any capital cost overruns incurred during the first 10 years above the forecasted costs reflected in the proposals will not be permitted into the successful proponent's rate base for year 11 and beyond (following the rate stability period). The treatment will be symmetrical: cost underruns will accrue to the utility's benefit.
- **Other CIP Parameters:** Royalty payments to the municipalities were to be excluded from the proposals if they are not recovered through the utility's revenue requirement. If the royalty payments are proposed to be collected from the revenue requirement, then the royalty payments were to be included in the revenue requirement for the CIP.

4.2 Assessment of CIP Proposals

The OEB has considered all aspects of the proposals, including those features emanating from the Generic Decision, and those that the OEB accepted as part of the proponents' request to have the OEB consider as competitive elements of the CIP proposals.

As described in the process section, after the CIP proposals were filed, two rounds of interrogatories were issued by the OEB to ensure that potential issues

and concerns were clarified. The OEB accepts EPCOR's responses to the most recent interrogatories regarding its earlier submissions.

The $\$/\text{m}^3$ CIP comparison criterion provides a relatively clear picture of value for money, as it shows on average, what customers could expect to pay on a per unit basis.⁵ The emphasis on volume in this metric also encourages the successful proponent to attach as many customers as possible, on the assumption that proponents understand that the goal of community expansion is to facilitate access to natural gas services to many customers, rather than serving only the most profitable customers. The OEB notes that the other two CIP comparison criteria (customer years and cumulative 10-year volume) provides a measure of which proposal most benefits communities in terms of getting service to customers most quickly and customers' potential for fuel savings.⁶ All three CIP comparison criteria also provide a potential check against "gaming" of the revenue requirement metrics associated with under-estimated capital and OM&A expenses.

Taking all elements of the CIPs into consideration, the OEB finds that the EPCOR CIP is most favourable to customers, and therefore EPCOR is granted certificates of public convenience and necessity for the South Bruce municipalities, conditional on the approval of its subsequent leave to construct application.

The key determinative factor in the selection of EPCOR as the successful proponent is the $\$/\text{m}^3$ of 0.2209, which EPCOR has committed to maintaining for the rate stability period, versus the $\$0.2444/\text{m}^3$ submitted by Union Gas. The OEB believes that the $\$/\text{m}^3$ measure is most relevant in terms of the cost to serve the customers, and a main concern and focus in terms of the competitive process. Additional measures may be deemed relevant in future competitions.

Given the competitive nature of this process, the OEB will require EPCOR to demonstrate that forthcoming leave to construct and rates applications are consistent with its CIP proposal.

⁵ Details of a cost allocation study would determine what costs each rate class would be expected to pay. Depending on how costs are allocated to the rate classes, there could be large differences in, for example, residential rates.

⁶ Given that natural gas is less expensive than most competing fuels, volumes consumed are a proxy for fuel cost reduction (the more natural gas consumed the greater the fuel cost reduction).

4.3 Municipal Franchise Agreements

The original applications filed by EPCOR on March 24, 2016 also requested that the OEB approve the terms of their franchise agreements with the South Bruce Municipalities. The form of the franchise agreements filed differs from the 2000 Model Franchise Agreement (MFA) in the following ways:

- The proposed franchise agreements contain termination provisions. If EPCOR fails to meet certain milestones dates at various points throughout the regulatory applications and construction, the municipalities have termination rights. The rationale was to ensure that EPCOR is actively pursuing this undertaking in a timely manner.
- The proposed franchise agreements provide for the payment of an annual fee by EPCOR to the municipalities following the commencement of operation of the gas system. The annual fee is 1% of gross revenue minus gas supply commodity costs.
- The proposed franchise agreements provide for a rebate of the Municipality's portion of any property or similar taxes payable by EPCOR for the first 10 years of operation.
- The proposed franchise agreements provide for the assignment of the agreements to a wholly or majority owned subsidiary of EPCOR.

Given that the scope of this proceeding was modified from its original form and precluded an adequate examination of the additional terms in the franchise agreements proposed by EPCOR, the OEB finds it appropriate to deal with the matter of franchise agreements in a separate proceeding.

4.4 Fitness to Operate

In the Partial Decision, the OEB contemplated subsequent financial and technical acceptance testing if EPCOR, as a new entrant to the Ontario natural gas market, was selected as the successful proponent.

In the OEB's approval of the transfer of Natural Resource Limited's assets to EPCOR's affiliate company (EPCOR Natural Gas Limited Partnership), the OEB noted that EPCOR Natural Gas Limited Partnership has access to EPCOR Utilities Inc. employees with experience in the areas of health and safety, regulatory, communications, engineering, planning and capital project

management. The OEB was satisfied that the proposed transaction would not lead to any adverse impact with respect to the reliability and quality of service. The OEB therefore finds that financial and technical acceptance testing will not be necessary for EPCOR Southern Bruce Gas Inc.

5 ORDER

THE BOARD ORDERS THAT:

1. A certificate of public convenience and necessity, attached as Schedule A to this Decision and Order, is granted to EPCOR Southern Bruce Gas Inc. to construct works or supply gas in the Municipality of Arran-Elderslie, excluding the geographic area of the former Township of Arran and the former Village of Tara. A current map of the Municipality of Arran-Elderslie, delineating EPCOR Southern Bruce Gas Inc.'s service territory therein, is attached as Schedule B.
2. A certificate of public convenience and necessity, attached as Schedule C to this Decision and Order, is granted to EPCOR Southern Bruce Gas Inc. to construct works or supply gas in the Municipality of Kincardine. A current map of the Municipality of Kincardine, delineating EPCOR Southern Bruce Gas Inc.'s service territory therein, is attached as Schedule D.
3. A certificate of public convenience and necessity, attached as Schedule E to this Decision and Order, is granted to EPCOR Southern Bruce Gas Inc. to construct works or supply gas in the Township of Huron-Kinloss. A current map of the Township of Huron-Kinloss, delineating EPCOR Southern Bruce Gas Inc.'s service territory therein, is attached as Schedule F.
4. EPCOR shall file a leave to construct application to serve the areas covered by the South Bruce Expansion Applications on or before October 12, 2018.
5. Eligible intervenors shall file with the OEB and forward to EPCOR Southern Bruce Gas Inc. their respective cost claims in accordance with the OEB's Practice Direction on Cost Awards on or before April 27, 2018.
6. EPCOR Southern Bruce Gas Inc. shall file with the OEB and forward to intervenors any objections to the claimed costs of the intervenors on or before May 4, 2018.
7. If EPCOR Southern Bruce Gas Inc. objects to the intervenor costs, intervenors shall file with the OEB and forward to Enbridge any responses to any objections for cost claims on or before May 14, 2018.
8. EPCOR Southern Bruce Gas Inc. shall pay the OEB's costs incidental to this proceeding upon receipt of the OEB's invoice.

DATED at Toronto, April 12, 2018

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary

SCHEDULE A

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

DATED: April 12, 2018

**Certificate of Public Convenience and Necessity for the
Municipality of Arran-Elderslie**

EB-2016-0137

Certificate of Public Convenience and Necessity

The Ontario Energy Board grants

EPCOR Southern Bruce Gas Inc.

approval under section 8 of the *Municipal Franchises Act*, R.S.O. 1990, c. M.55, as amended, to construct works to supply gas to the

Municipality of Arran-Elderslie

as it is constituted on the date of this Decision and Order, excluding the geographical areas of the former Township of Arran and the former Village of Tara.

DATED at Toronto, April 12, 2018

ONTARIO ENERGY BOARD

Original Signed By

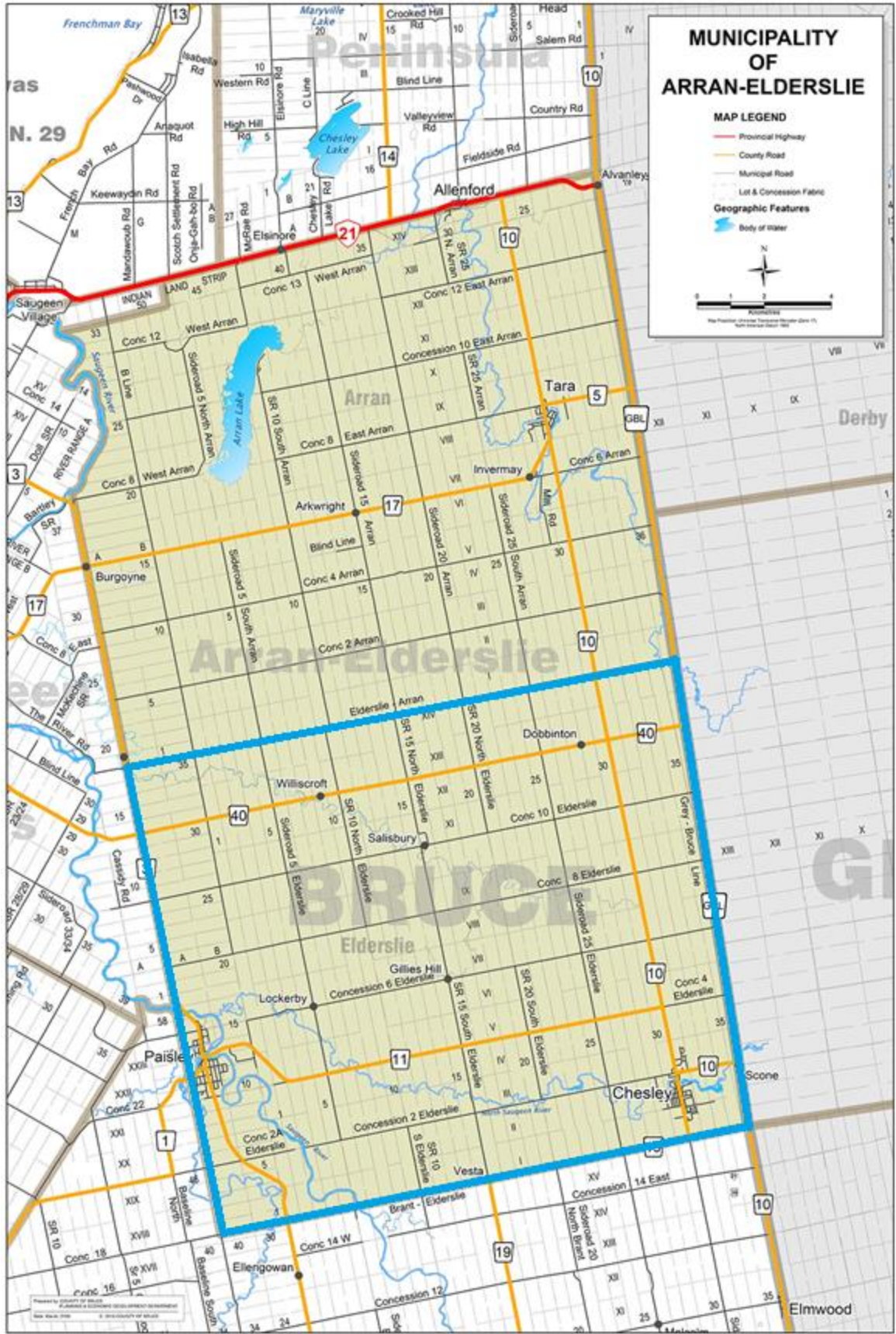
Kirsten Walli
Board Secretary

SCHEDULE B

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

DATED: April 12, 2018

Map of the Municipality of Arran-Elderslie



SCHEDULE C

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

DATED: April 12, 2018

**Certificate of Public Convenience and Necessity for the
Municipality of Kincardine**

Certificate of Public Convenience and Necessity

The Ontario Energy Board grants

EPCOR Southern Bruce Gas Inc.

approval under section 8 of the *Municipal Franchises Act*, R.S.O. 1990, c. M.55, as amended, to construct works to supply gas to the

Municipality of Kincardine

as it is constituted on the date of this Decision and Order.

DATED at Toronto, April 12, 2018

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary

SCHEDULE D

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

DATED: April 12, 2018

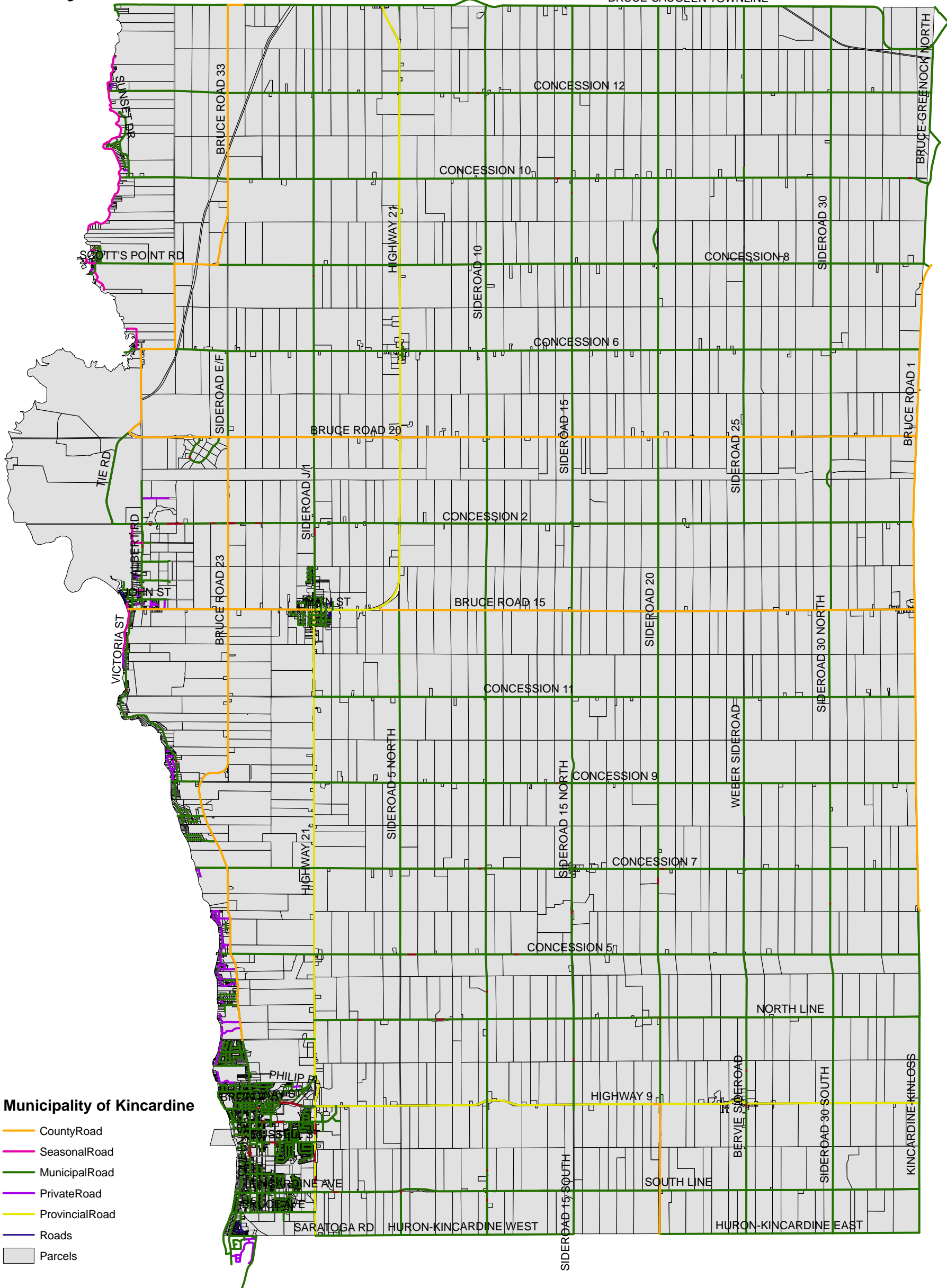
Map of the Municipality of Kincardine



Municipality of Kincardine



BRUCE-SAUGEEN TOWNLINE



Municipality of Kincardine

- County Road
- Seasonal Road
- Municipal Road
- Private Road
- Provincial Road
- Roads
- Parcels

SCHEDULE E

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

DATED: April 12, 2018

**Certificate of Public Convenience and Necessity for the
Township of Huron-Kinloss**

EB-2016-0139

Certificate of Public Convenience and Necessity

The Ontario Energy Board grants

EPCOR Southern Bruce Gas Inc.

approval under section 8 of the *Municipal Franchises Act*, R.S.O. 1990, c. M.55, as amended, to construct works to supply gas to the

Township of Huron-Kinloss

as it is constituted on the date of this Decision and Order.

DATED at Toronto, April 12, 2018

ONTARIO ENERGY BOARD

Original Signed By

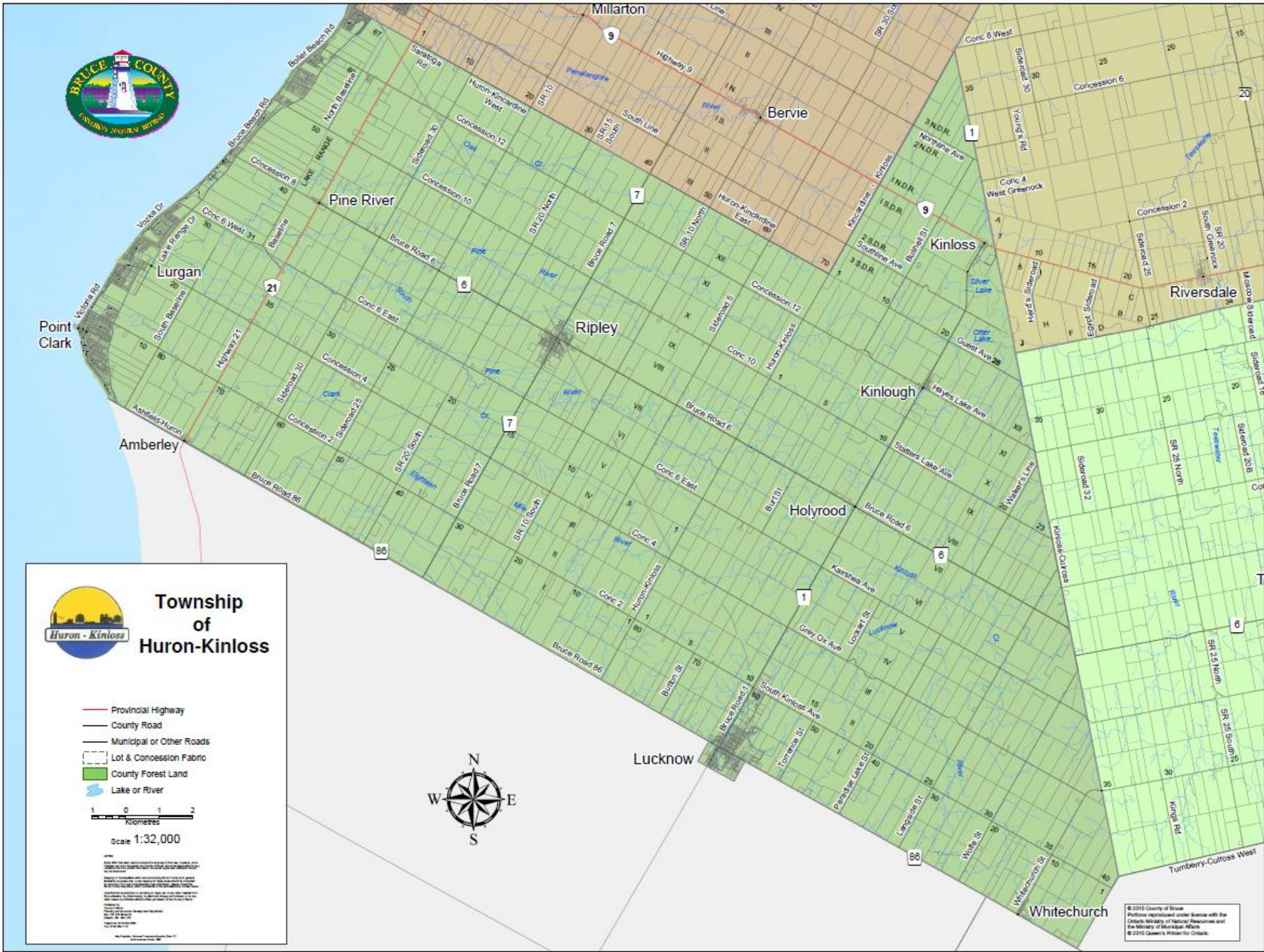
Kirsten Walli
Board Secretary

SCHEDULE F

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

DATED: April 12, 2018

Map of the Township of Huron-Kinloss



Township of Huron-Kinloss

- Provincial Highway
- County Road
- Municipal or Other Roads
- Lot & Concession Fabric
- County Forest Land
- Lake or River



Scale 1:32,000



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 the Ministry of Municipal Affairs
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