Ontario Energy Board

IN THE MATTER OF an Application for approval to amalgamate Enbridge Gas Distribution Inc. and Union Gas Limited and for approval of a rate-setting mechanism and associated parameters from January 1, 2019 to December 31, 2028.

ENERGY PROBE RESEARCH FOUNDATION

("ENERGY PROBE")

ARGUMENT

June 15, 2018

SECTION I: Executive Summary

1. **Energy Probe Research Foundation ("Energy Probe") accepts that a merger between Union Gas and Enbridge Gas Distribution ("Amalco") has merits, particularly in light of the fact that the two utilities are already owned by the same corporate entity**. As such, Energy Probe is not opposed to the merger being approved. In Energy Probe's view, if the Board decided *not* to approve the merger, ratepayers across the province would, in many cases, pay unnecessary costs for duplicative services. The utilities' corporate costs, as one example, can certainly be reduced and consolidated now that the utilities are under the same corporate umbrella.

2. While having one gas distributor in the province is not ideal from a competitive and economic standpoint, the move from two regulated monopolies to one doesn't appear to Energy Probe to be a drastic concern, given that the regulatory mechanisms to protect consumers and ensure rates are "just and reasonable" will remain in place. If the Board upholds the mantle of economic regulation, ratepayers should be adequately protected.

3. **Energy Probe is opposed to the rate-setting portion of Amalco's application.** The application, as it's currently presented, amounts to a "gun to the head" proposal: give us everything we want or we'll walk. Unlike every other application that comes before this Board, the utilities are placing an asterisk next to it and saying that they'll have to review the Board's decision before they agree to move forward with the merger. What Amalco is really saying is: it wants the maximum incentive available in the Mergers, Acquisitions, Amalgamations and Divestitures (MAADs) policy in order to move forward with the merger and, if it doesn't get it, the utilities will try a new tactic.

4. This is totally backwards from a regulatory perspective. Under this model, utilities that come before this Board would table high cost or aggressive custom rate applications and then, if they don't like the decision, scrap the application and start over. The Board would be forced into a situation in which it would have to consider whether its decision is acceptable to a utility's management. But that's clearly not how the regulatory model works and the Board's mandate is clearly to set "just and reasonable" rates – not "just and reasonable rates for the utility's management." When tabling an application before the Board, the utilities make their case for why this is the best application, both for the utility and its ratepayers. The Board decides whether the application has been sufficiently supported by evidence and then decides accordingly, making any changes that it sees fit. Only under extreme circumstances do utilities object to the Board's decision. Amalco's proposal that it would go ahead with the merger only if it likes the Board's decision doesn't fit within the regulatory model in Ontario and would dilute the regulatory process.

5. **The no-harm test has not been sufficiently satisfied.** As detailed in Section IV, it's not clear that ratepayers are left harmless by the current application. Amalco's interpretation of no-harm is that ratepayers would are better off under this application than the utility's constructed

counterfactual. Energy Probe finds Amalco's counterfactual problematic for a variety of reasons and, as such, doesn't believe the utility has clearly documented that its rate-setting application passes the no-harm test.

6. **Energy Probe suggests that the Board reject that proposal as it is currently presented.** Amalco has failed to adequately explain why two companies that are already owned by the same corporate parent – and now have a de facto monopoly over the province's gas sector – require the maximum incentive to merge. Energy Probe also views the ten-year deferral as clearly out of the norm of regulatory practice and, coming on the back of a five-year incentive rate plan, creates a 15-year lag between the utilities' cost structure and the setting of rates. Energy Probe is concerned that, given the lengthy period between re-basing and the many cost allocation issues (among others) it will create, rates would no longer be considered "just and reasonable." Energy Probe suggests the Board consider two options:

    - First, deny the rate-setting application, freeze rates at current levels and request that Amalco present a detailed re-basing and rate-setting application at the earliest date (likely 2021). In the meantime, there would no earnings sharing mechanism and no stretch factor. This would be more in line with what has occurred in other merger applications approved by regulators across North America, as detailed in Energy Probe's evidence. Under this proposal, Amalco continues to keep all of the productivity savings it has achieved in the past five years, while also keeping any additional savings that will occur with limited capital investment in the next two to three years. Amalco has already found $5.2 million in merger savings, starting in 2017, for example.[1] Ratepayers are left harmless, as their rates will remain at the same level.
    - Second, if the Board were to decide that the merger and rate-settling application should be approved, but not to its full extent (which Energy Probe views as unreasonable), it could consider a five-year price cap rate plan, with earnings sharing of 75:25 (ratepayer-to-shareholder) on all earnings above 100 basis points. Amalco would then rebase at the end of the five-year term. The Board would apply a 0.3 percent stretch factor, as suggested by Dr. Lowry. In Energy Probe's view, considering that the utilities are not allowing ratepayers to "claw back" any productivity savings achieved over the past five years and have consistently earned above their approved ROEs, this proposal strikes a balance of sharing benefits between the utility and ratepayers.[2] Amalco is allowed to keep a reasonable amount of over-earnings, while ratepayers benefit from a stretch factor – amounting to an up-front benefit – going forward and a share of additional savings Amalco may find over the next five years.

[1] EB-2017-0306, Exhibit JT3.1
[2] EB-2017-0306, Exhibit JT1.3

SECTION II: MAADs doesn't apply in this case

7. The MAADs policy was clearly designed to deal with the Ontario's unique situation as it relates to the province's local distribution companies (LDCs). The January 2016 "Handbook to Electricity Distributor and Transmitter Consolidations" clearly lays out the case – citing multiple government commissions and reviews – on why consolidation of the province's many LDCs should be encouraged. Nowhere does it mention the consolidation of the province's two gas companies.[3] In fact, the word "gas" appears nowhere in the document. The province's 2017 Long-Term Energy Plan (LTEP) explicitly talks about consolidating electricity distributors across the province in an effort to reduce costs (and rates) for customers. It doesn't mention moving from two gas distributors in Ontario – they will also own the transmission and storage market – to one.[4]

8. Without going into detail and historical background, the MAADs policy, as it was initially established, didn't incent a significant level of merger activity among LDCs. As a result, the Board increased the incentive, most significantly by stretching the deferral period from five years to ten years. The incentives in the MAADs policy were increased explicitly to further encourage consolidation among electricity distributors, as the previous policy had failed to kickstart the intended trend in consolidation. Again, nowhere was there a concern about consolidating the two largest gas companies.

9. But more simply, Amalco doesn't need an incentive to merge, as the parent companies did so and did so with little to no regard for the Ontario gas distribution business. The MAADs policy had nothing to do with that decision. Amalco's witnesses fully admit that when the merger took place, there was no discussion about finding savings and efficiencies in the Ontario gas business.[5] In short, Amalco admits that its parent companies didn't consider the incentives contained in the MAADs policy as a reason to merge their two gas distribution businesses. Those incentives, at least in this case, were unnecessary in the decision to merge the two utilities and Energy Probe fails to see why these incentives should be applied in full in this proceeding.

10. Even without the incentives contained in the MAADs policy, Union and Enbridge are already pursuing – albeit small – opportunities on their own to achieve efficiencies and lower costs. To date, they have already uncovered $52 million in savings (over ten years) and, according to their application, there is $180 million in savings to be found by reducing management levels at the two utilities.[6] Those management savings kick in almost immediately and, as far as Energy Probe

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[3] Handbook to Electricity Distributor and Transmitter Consolidations, page 1
[4] 2017 Long-term Energy Plan, page 79.
[5] EB-2017-0306, Transcript Volume 1, page 29
[6] EB-2017-0306, Exhibit JT3.1 and EB-2017-0306, Exhibit C.BOMA.16, Attachment 1

can tell, are not fully dependent on fully merging operations. That means that, as it currently stands, there is at least $230 million of savings over the next ten years that require very little investment or risk to achieve – in fact, some of the investments have already been made. Additional savings will likely be found in reducing duplication in Demand Side Management (DSM) expenses and other, similar programs (cap and trade, for example) without requiring much (if any) investment from Amalco's shareholder.

11. In short, the MAADs policy was intended to incent utilities to amalgamate and, in the process, reduce costs. But Enbridge and Union are already finding ways to reduce costs for customers. And, as pointed out in the previous paragraph, there are easy ways to potentially reduce costs by hundreds of millions of dollars more without requiring the maximum MAADs incentives to achieve.

12. And finally, the question Energy Probe asked itself and its supporters: did the MAADs policy envision a scenario in which it would explicitly encourage – generously – the creation of the one of the largest gas utilities in North America?[7] We don't believe so. Energy Probe's evidence, as discussed in more detail below, shows that many regulators view large utility mergers with skepticism and question whether the new, merged utility would be better for ratepayers on a range of metrics, including rate impacts, operations and the overall impact on the local economy. Utilities very often responded to those concerns by negotiating benefits with parties to the proceeding and offering a range of up-front benefits as a means to reduce those concerns. They never relied on regulator-approved incentives to move ahead with the merger. In contrast, Amalco's application applies the maximum incentive available under the MAADs policy while also suggesting that its proposal passes the "no harm" test by using a straw-man scenario that is, in Energy Probes view, severely deficient. Furthermore, by not including a stretch factor, ratepayers aren't receiving benefits "up-front" and "throughout the term."[8] It's not clear that the, admittedly low bar, of the "no harm" test has been sufficiently met. What is clear is that Amalco's application and proposal is in many ways an outlier to what has occurred in jurisdictions across North America and, in our view, the MAADs policy shouldn't be the sole reason for approving it in its current form. Energy Probe suggests that the Board should not accept it as it is currently presented.

SECTION III: Energy Probe's evidence clearly shows this application is not the norm

13. Energy Probe's evidence clearly shows that there are two parts of this proceeding that are not in line with standard regulatory practices across North America.

14. First, the ten-year deferral period – established as an incentive in the MAADs policy to encourage utility consolidation – is significantly longer than every merger or amalgamation

[7] [7] EB-2017-0306, Transcript Volume 2, page 22
[8] Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, page 42

reviewed as part of our evidence.[9] More importantly, nearly all rebasing deferrals in other mergers were done with utilities on a cost-of-service regulatory regime, meaning the deferral was negotiated as a benefit to ratepayers (and a cost to the utility). In this case, the ten-year deferral is a benefit to Amalco, as it allows the utility to increase rates at the full inflationary rate for the next decade, while also flowing through incremental capital costs of more than $2 billion through the Incremental Capital Module (ICM). There is little, if any, risk to the utility in this application. The ten-year deferral also prevents ratepayers from "clawing back" productivity savings that were found in the previous five-year rate application. Overall, the average customer will experience an annual rate increase of 2.4% over the next decade.[10] Other customers will experience significantly higher rate increases. [11] When other charges are included – such as cap and trade costs – the average annual increase is likely to be significantly higher than is laid out in Amalco's proposal.

15. Most regulatory bodies and other parties involved in merger applications steered clear of long deferral periods for a simple reason: they were skeptical that the promised benefits of the merger would, ultimately, become a reality and the longer the utility was out from under the regulator's review, the larger that risk became.[12] To ensure ratepayers did receive those promised benefits, regulators often took two approaches. They either required— and sometimes the applicants willingly offered – an up-front rate-credit, rate freeze or rate moratorium to drag those long-term benefits to the current period.[13] Or, secondly – and sometimes in addition to – the regulator would stipulate that the applicants present detailed plans and cost/benefit analysis studies for any investments made as part of the merger in order to lower utility costs (and, subsequently, rates).[14]

16. In this application, there is no detailed plan for any savings that will occur as a result of the merger, but rather a very high-level document with very little evidence on how – or what – type of savings will actually occur. Furthermore, the "no harm" threshold to ratepayers, as detailed in Section IV is merely a hypothetical case of what "would have happened" if Enbridge and Union continued as separate organizations. But once the many details of that hypothetical situation were tested under cross examination, it's clear that this "benefit" to ratepayers is incredibly subjective and far from certain. The "standalone" scenario makes a number of assumptions that

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[9] Review of Reglatory Decisions on Applications for Approval of Utility Mergers and Acquisitions in North America ("Energy Probe Evidence"), page 3
[10] EB-2017-0306 Exhibit J5.1, Attachment 2
[11] EB-2017-0306, SEC Compendium Number 2, page 6
[12] See example 20 in Energy Probe's evidence, Gas Metro purchases Central Vermont Public Service Corp.
[13] See cases 4,5,7,8,12,14,26 in Energy Probe's evidence as an example of this.
[14] See cases 4,10,12,20, 26 in Energy Probe's evidence as an example of this.

are beneficial to Amalco's argument and ignore the impact of productivity savings that have occurred at the two utilities in the last five years, as well as assuming there will be no more productivity going forward. Unlike many other merger applications across North America where ratepayers were offered – or negotiated – some immediate or guaranteed benefit from the merger, the benefits in this proceeding are fully premised on a hypothetical counterfactual. The lack of a stretch factor in Amalco's proposal further solidifies its position that no benefits will be shared with ratepayers up-front. Additionally, there will be no earnings sharing for at least five years.

17. The second aspect of this proceeding that is clearly out of the norm of regulatory practice in North America is that there have been no negotiations between parties to this proceeding and Amalco, as has occurred in nearly every other merger application.[15] The importance of settlement negotiations cannot be understated, as they often resulted in significant shifts in positions from both the applicants and parties. Settlement negotiations made it clear what positions were "off the table" from both the applicants' and parties' viewpoint and allowed the various parties to work from that starting point. In nearly every application reviewed, the settlement negotiations resulted in a softening of positions.[16]

18. But in this proceeding, it's not clear if Amalco is, in any way, flexible in its positions. The result is an "all or nothing" proposal that will, very likely be rejected by nearly every party to this proceeding – leaving the Board as the sole party to decide what is reasonable. A negotiated settlement – as has occurred in the past with the gas utilities' five-year rate applications – would, in Energy Probe's view, have softened the positions of many, if not all, of the parties to this proceeding. Negotiated settlements can work in tandem with incentive regulation, with Stephen Littlechild, one of the main architects of incentive regulation in the United Kingdom, having recently published a paper celebrating the negotiated settlement process as an efficient and cost-effective manner to set rates.[17] The earlier the Amalco rebases, the earlier the opportunity for a negotiated settlement arises.

19. And finally, Energy Probe's evidence laid out 14 stipulations that were common to most investor-owned utility applications to merge or amalgamate rate-regulated businesses.[18] None

[15] Review of Reglatory Decisions on Applications for Approval of Utility Mergers and Acquisitions in North America ("Energy Probe Evidence"), page 6-7
[16] In the case of the Exelon-Constellation merger, the applicants twice improved their "offer" to parties in the proceeding, even though their initial position was adamant that this was the best offer they could present.
[17] https://www.repository.cam.ac.uk/handle/1810/241875
[18] Review of Reglatory Decisions on Applications for Approval of Utility Mergers and Acquisitions in North America ("Energy Probe Evidence"), page 7-9

of those stipulations are clearly present in this proceeding. Instead, Amalco concludes that ratepayers are better off than the hypothetical "standalone" scenario it has presented in its application. As detailed in the next section, under closer scrutiny, it's not clear that the no-harm test threshold has been adequately cleared.

SECTION IV: The no-harm test hasn't been sufficiently proven.

20. Amalco's proposed method of proving that its application passes the "no-harm test" is comparing it to what would occur under what Amalco refers to as the "standalone" scenario, in which the two gas utilities would continue to operate as stand-alone entities and submit separate rate applications (one every five years for each utility). Under that scenario, ratepayers would pay an additional $410 million in rates over the next ten years than they would under Amalco's proposal for a ten-year deferral and price-cap rate regime.

21. Yet, the $410 million benefit to ratepayers contained in Amalco's application compared to its standalone scenario is full of question marks and assumptions that favour Amalco's position.

22. To start, Amalco confirmed that the standalone scenario considers "no sharing of staff or rationalization of activities."[19] Yet, when asked in an undertaking at the technical conference, Amalco showed that it has already begun to integrate its operations. In 2017 alone, the two utilities spent $9.2 million to achieve $5.2 million in corporate cost savings – amounting to $42.8 million in net savings over a ten-year period.[20] Amalco confirmed during the hearing that the overall savings achieved from merging operations will be at least $52 million (not including the cost to achieve those savings).[21] Yet, when asked, Amalco admitted that it modeled no corporate cost savings in its standalone scenario, even though its own evidence shows that these savings are already happening.[22] Ultimately, the savings Amalco has achieved in 2017 will flow to its shareholders over the next ten years, and not shared with ratepayers, as there is no rebasing in 2019.

23. Amalco also didn't factor in any future savings in its business development and field operations, but admitted that those will likely occur. Regarding business development, Amalco's witnesses confirmed that, as it currently stands, some of those services are already provided by Enbridge Inc., which could also provide them to Union Gas.[23] In terms of field operations, Amalco admits that there will be savings, but says they would be "very small" and would occur in years five to

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[19] EB-2017-0306, Transcript Volume 1, page 146
[20] EB-2017-0306, Exhibit JT3.1
[21] EB-2017-0306, Transcript Volume 6, page 96
[22] EB-2017-0306, Transcript Volume 1, page 31
[23] EB-2017-0306, Transcript Volume 1, page 33

ten of its ten-year rate plan. But when asked what planning was done to determine why those savings (or lack thereof) would be very small, Amalco's witness confirmed "they haven't done any specific planning."[24] Parties to this proceeding are to simply accept that savings in these areas – which are large parts of Amalco's operations – won't be material, even though nobody knows if that's actually the case. If the savings are material, they will flow completely to the shareholder. And due to the ten-year time frame for deferral, small savings in the early years of the application – $10 million for example – can add up significantly over the test period ($100 million in this example). It's not clear that Amalco is taking this into consideration when it says savings aren't material.

24. In the same response, Amalco also confirmed that, in its standalone scenario, it has factored in no productivity savings in its capital spending.[25] Again, any savings that are found in this part of the business, under the standalone scenario, flow to the shareholder.

25. The Demand Side Management (DSM) operations at the two utilities will also likely be integrated to some extent, although Amalco hasn't considered such integration in its standalone scenario. Amalco currently charges ratepayers $129 million in operating costs for its DSM programs ($66 million for Enbridge and $63 million for Union).[26] While the current DSM plan runs until the end of 2020, in Energy Probe's view, it's not unreasonable to assume the utilities would be able to find some level of savings, as DSM spending accounts for about 15% of total OM&A budgets. As an example, a 10% reduction in DSM spending in 2021 (when a new DSM application would likely begin) amounts to $103 million in reduced OM&A costs by the end of 2028. Nonetheless, Amalco says it has not factored in any operating savings for its DSM programs in its standalone scenario that extends to 2029.[27] Yet again, any savings that are found will flow to the shareholder.

26. Amalco is also collecting excess corporate costs and will continue to do so in the future.[28] Corporate costs are not an insignificant amount. In 2018, EGD is forecasting corporate costs of $60 million – or $25 million more than the $35 million that was approved under the Regulatory Cost Allocation Model (RCAM).[29] Over a ten-year period, this amounts to around $250 million in excess fees in approved RCAM charges for EGD alone. As for Union's affiliate expenses, it currently forecasts them to be $18 million in 2018, but with a $26 million adjustment (as we

[24] EB-2017-0306, Transcript Volume 6, page 94 and 95
[25] EB-2017-0306, Transcript Volume 6, page 95
[26] EB-2017-0306, Exhibit C.FRPO.11
[27] EB-2017-0306, Transcript Volume 1, page 61 and 62
[28] EB-2017-0306, Transcript Volume 1, page 181
[29] See EB-2017-0306 Exhibit C.EP.5 and EB-2012-0459, Decision with reasons, page 41

interpret Union's response to Energy Probe's questions).[30] Over ten years, if Union's corporate costs grow to a similar level of EGD's, Amalco could be collecting an additional millions of dollars above approved levels. Amalco admitted that it doesn't know what those corporate costs will be going forward, so it's not clear that they will fall back to OEB-approved levels. Nor was it able to file an updated corporate services agreement. Energy Probe is concerned that ratepayers will continue to pay costs that are in excess of approved corporate costs until rebasing. It appears that Amalco has baked these excess charges into its standalone assumptions, when – if they were required to rebase – may be lowered to approved levels or reduced as a result of the two utilities sharing the same corporate parent. [31]

27. Amalco also assumes that there is no longer any productivity savings to be found at either one of the gas utilities unless they merge. None. Amalco wants this Board and parties to this proceeding to believe that not one single dollar of productivity savings can be found between two utilities that have, combined, nearly a $900 million annual operating budget. Repeatedly, Amalco maintained that the "low hanging fruit" in terms of productivity savings has been picked.[32] The standalone scenario is based on that assumption.[33] Amalco assumes that under the standalone scenario, the four rate applications that will be submitted – two, five-year applications for each utility – would include a zero stretch or productivity factor, even though the Board has explicitly rejected the idea of a zero percent stretch factor and, more recently, approved a 0.3% stretch factor for OPG's hydroelectric assets when the utility's evidence suggested a negative productivity factor.[34] If the Board were to accept this argument, it would be admitting that, in terms of distributing gas in Ontario, we've hit the end of productivity. Energy Probe finds this argument incredulous and completely out of line with Board policy.

28. The gas utilities have made similar arguments in previous rate applications. In the interest of time, Energy Probe will focus only on EGD. In its previous application for setting rates over five years, EGD said it would be a "challenge" to meet its productivity forecasts and that those forecasts weren't "realistic." The utility also claimed that because the productivity targets and other forecasts were challenging and unrealistic, it would be a struggle to meet the ROE projections included in its application. EGD admitted that it was unlikely to achieve anything above 100 basis points of its approved ROE over the next five years.[35]

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[30] EB-2017-0306, Exhibit C.CCC.15, page 4
[31] EB-2017-0306, Transcript Volume 1, page 181
[32] EB-2017-0306, Transcript Volume 2, page 87, EB-2017-0306, Transcript Volume 4, page 30, EB-2017-0306, Transcript Volume 4, page 31 and EB-2017-0306, Transcript Volume 6, page 74
[33] EB-2017-0306, Transcript Volume 2, page 127
[34] EB-2016-0152, Decision and Order, page 124-129
[35] EB-2017-0306, EP Compendium Panel 1, page 7-22

29. Yet, not only did EGD find those productivity savings, it blew past them and its ROE projections. In Enbridge's case, it earned around $351 million above its approve ROE between 2008 and 2017, while Union earned $309 million over its approved ROE.[36] In EGD's case, it earned 100 basis points above its ROE in eight of the ten years between 2008 and 2017.[37] At no point over the last decade have either of the utilities earned below their allowed ROE. Not only was the "low hanging fruit" in terms of productivity very lucrative for the two utilities over the past decade, but it's been a consistent crop.

30. While Amalco's witnesses were clear that the utility doesn't expect those overearnings to continue in the future, they made similar remarks in their previous rate applications and, as a result, Energy Probe is not convinced that will be the case going forward.[38] Union, for example, continued to earn above its approve ROE in 2018.[39] If we were to apply Enbridge's overearnings of $47 million in 2017 (the most recent figures) and Union's estimate of $16.9 in million in overearnings in 2018 going forward, Amalco would earn more than $640 million in excess earnings over its proposed test period. And just for added clarity, Union has been able to achieve greater-than-allowed earnings over the past five years while having an inflationary factor set at 60% of inflation and a $4.5 million up-front productivity commitment.[40] Energy Probe fails to see why suddenly the productivity savings and excess earnings the utilities were able to generate in the last decade stop in 2019. We find this argument lacking in credibility.

31. There is also a significant lack of clarity around what level of rate increases would be approved in 2019 under the standalone scenario, as a significant level of productivity savings achieved over the past five years would likely be "clawed back" by ratepayers – something the utilities were clear about in their previous rate applications.[41] In fact, that's one of the key components to incentive regulation, as well as a key part of the settlement agreements agreed to as part of the current rate plan.[42] But the proposed amalgamation proposal from Amalco proposes to not only retain for the next decade the productivity savings that have occurred over the last five years, but then add an additional $120 million in savings that it would receive as part of its merger investments. In Energy Probe's view, this is a one-sided interpretation of incentive regulation.

[36] EB-2017-0306, Transcript Volume 1, page 69
[37] EB-2017-0306, Exhibit JT1.3
[38] EB-2017-0306, Transcript Volume 1, page 69-72
[39] EB-2017-0306, Exhibit C.SEC.19, Attachment 1
[40] EB-2013-0202, Exhibit A, Tab 1, Page 1
[41] EB-2017-0306, Transcript Volume 1, page 174 and 179.
[42] EB-2017-0306, EP Compendium, Panel 1, page 10

32. Further clouding what level of rates would be set in 2019 is the fact that, at least in the case of Enbridge, its approved rate base and actual rate base are out of line with one another. Enbridge, for example, has a rate base that is more than $457 million higher than is currently included in its rates. The cost to the utility of not rebasing – and including that amount in its rate base going forward – is $369 million over the next decade.[43] On the surface, it would appear that this is a "benefit" to ratepayers, but Amalco's witnesses confirmed that some of that difference in rate base is a result of overspending on capital projects and may be disallowed by the Board in a re-basing application.[44] Furthermore, Enbridge has also been able to earn above its approved ROE in every single year of its current rate application, even without this "lost" rate base amount. If that rate base was included, its overearnings would be even more extreme.[45]

33. When questioned about the lack of productivity in its standalone forecasts, Amalco responded that productivity is "implicit", as the company isn't increasing costs, even though it will be adding new customers throughout the test period. [46] But at the same time, Amalco's witnesses confirmed that they would be receiving additional revenues from these new customers, but it is "not looking" at that additional revenue.[47] Given that there is no evidence on this "implicit" productivity, Energy Probe suggests that the Board discount it, or ignore it altogether, as it is not based on empirical evidence (there is no benchmarking, for example).

34. But the lack of clarity between the standalone scenario and cost-saving measures that will be realized if the merger application is approved also extend to who, exactly, came up with the numbers underpinning the application. The witnesses on the stand repeatedly said they stand by the cost-saving numbers – that the numbers come from experience. But parties to this proceeding don't actually know who that experience lies with, as we don't know who actually derived those figures, what method they used, what similar mergers they referenced and why they think these estimates are reasonable.[48] Amalco admits it has done no detailed analysis on the savings it could achieve right now without having to apply to the Board to merge the two utilities – meaning it's not clear what portion of these savings can only be achieved through amalgamation and what will occur regardless.[49] Amalco, ultimately, readily admits that these are

[43] EB-2017-0306, Transcript Volume 6, page 34-35.
[44] EB-2017-0306, Transcript Volume 6, page 40
[45] EB-2017-0306, Transcript Volume 6, page 42
[46] EB-2017-0306, Transcript Volume 2, page 131 and 132.
[47] EB-2017-0306, Transcript Volume 2, page 131 and 132.
[48] EB-2017-0306, Transcript Volume 2, page 61 and 62.
[49] EB-2017-0306, Transcript Volume 1, page 43.

simply "high level" assumptions derived by employees at Amalco that never took the stand and had to answer for how they established them.[50] Again, Energy Probe fails to see how these numbers – both in terms of the cost to achieve savings and the benefits that will be derived from them – can be taken seriously when they appear to be little more than vague estimates done by somebody at Amalco that never had to defend them before the Board.

35. Ratepayers – particularly Union's current ratepayers – will also not be held harmless from the increased credit risk of Enbridge Inc. As laid out in Energy Probe's evidence, ring-fencing local operations from credit risk at the parent company is common in nearly every merger application reviewed. But as part of Amalco's proposal, if Enbridge Inc.'s credit rating was downgraded, for example, and its interest costs were to increase as a result, it may include such an event as a Z Factor and come before the Board to collect those costs from ratepayers.[51] Clearly, Ontario ratepayers should, in no way, be on the hook for increased costs that occur as a result of credit rating issues facing the parent company and that have nothing to do with the local gas distribution business. In Energy Probe's view, the Board should include a condition of approval that protects Ontario ratepayers from increased credit risk at the corporate level.

36. Amalco is proposing a Z Factor of $1 million, which is materially lower than the combined Z Factor of the stand-alone utilities. Ratepayers are clearly harmed by this change. The current Z factor for Enbridge and Union is $1.5 million and $4 million, respectively.[52] Energy Probe believe a more appropriate comparison would be the Board's recent decision on OPG's Z Factor. In that hearing (EB-2016-0152) the Board set a Z Factor of $10 million.[53] Given that Amalco is now the largest utility in Ontario and will be one of the largest gas utilities in North America, Energy Probe suggests that a $10 million Z Factor is more appropriate. Dr. Lowry's evidence also pointed out that Amalco's Z Factor is "low" and that a "higher threshold is warranted."[54]

37. Regarding storage issues, Amalco maintains that, post-amalgamation, Enbridge customers will be no worse off than at present. Enbridge, post-amalgamation, will continue to purchase excess storage from Union. In 2018, for example, Enbridge purchased an additional 25 PJ of storage from Union and its affiliates to meet peak demand requirements. Amalco maintains that Union, which has not used its full NGEIR storage allocation, will continue to "sell" a portion of its regulated storage to Enbridge at market rates.[55] In doing so, it will generate about $4.5 million in

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[50] EB-2017-0306, Transcript Volume 2, page 58
[51] EB-2017-0306, Transcript Volume 5, page 31
[52] [52] EB-2017-0306, Transcript Volume 1, page 140.
[53] EB-2016-0152, Decision and Order, page 133
[54] IRM Framework for the Proposed Merger of Enbridge and Union Gas, page 53
[55] EB-2017-0306, Exhibit J3.4 and Transcript Volume 3, page 46

revenue that flows to its customers, with 10% of that amount flowing directly to its shareholder.[56]

38. It's not clear to Energy Probe that this passes the "no-harm" threshold, as it pits one pool of ratepayers versus another, when both are now being serviced by the same utility. If the Board approves the merger, then rates should be based on a cost-causality principle, not on previous arrangements that were established when there were two, stand-alone utilities. Requesting different rates for regulated storage amounts solely because of the historic NGEIR allocation – set in 2005 – is nonsensical and certainly harms one class of customers. Energy Probe suggests that the Board either consider having one "pool" of regulated storage, move it all to market-based rates or re-open the NGEIR decision.

39. Amalco's proposal to continue its more than 50 deferral accounts also doesn't pass the "no harm" test. Energy Probe has two main concerns. First, there is a surfeit of deferral and variance accounts that will continue to be used post-amalgamation.[57] The number and breath of the deferral accounts is concerning from a regulatory efficiency perspective, as well as the transferring of risk from the utility to ratepayers. Second, the applicants have both previously agreed to revaluate their Average Use True UP (AUTVA) and Normalized Average Use (NAC) accounts when re-basing. Continuing these accounts – when they clearly need adjusting – creates asymmetric risks for ratepayers related to the long-term trend of falling average use, while protecting the utilities from that same risk. Energy Probe recommends that the Board reject, at the very least, the two average use variance accounts, pending a full review at rebasing, as was previously agreed to by the applicants.

SECTION V: Amalco's expert evidence is in direct contradiction to Board policy and other jurisdictions

40. Amalco's evidence for a zero percent stretch factor relies on two points, both of which, in Energy Probe's view, should be dismissed by the Board. First, Dr. Makholm, suggests that a stretch factor is only necessary when transitioning from a cost-of-service regime to incentive regulation.[58] In his view, because both Enbridge and Union have been on incentive rate plans for 15 years, it's no longer necessary to apply a stretch factor. Secondly, Dr. Makholm's evidence highlights a negative productivity trend among utilities, meaning the application of a positive stretch factor would contradict what is happening in the utility sector.

41. First, the Board is currently on its fourth round of incentive regulation and, as highlighted in this proceeding, continues to apply a positive stretch factor on utilities. While Dr. Makholm seems to

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[56] EB-2017-0306 Exhibit C. Staff 10, Transcript Volume 3, page 49 and EB-2018-0105 Exhibit A Tab 1, Page 8
[57] EB-2017-0306 Exhibit C. EP 25
[58] EB-2017-0306, Transcript Volume 4, page 16 and 20

believe this is inappropriate, it's the Board's current policy.[59] Energy Probe sees no reason why the Board should abandon that policy for Amalco.

42. Second, other jurisdictions that have been using incentive regulation for as long – or longer – than Ontario continue to apply stretch factors when setting rates. Dr. Lowry mentioned this during the oral hearing. A recent decision from the British Columbia Utilities Commission (BCUC) confirms this. In setting 2014-2018 rates for FortisBC Inc. and FortisBC Energy Inc., the regulator applied a stretch factor of 0.1% and 0.2%, respectively, even though at least one of these utilities had been on two previous incentive rate plans.[60]

43. Furthermore, while Amalco maintains that it's been on incentive regulation for 15 years, in the case of Enbridge, it's current rate plan contains many cost-of-service elements.[61] If the Board were to fully accept Amalco's position that stretch factors are only appropriate when transitioning from a cost-of-service regime to incentive regulation, how would it deal with this? Under that argument, at least some form of a stretch factor should apply, as some part of Enbridge's current rates employ cost-of-service elements.

44. Yet, even though Amalco maintains that stretch factors are only appropriate in a rate regime transition, both utilities' current rate plans already contain some form of a stretch factor. In the case of Union, it committed to an up-front productivity factor of $4.5 million dollars, which is essentially a stretch factor in everything but name. In fact, Union concluded in its evidence that, "together, the Upfront Productivity Commitment…and the X factor are inclusive of a stretch factor." [62] Enbridge made a similar comment regarding its proposal to hold Full-Time Equivalent (FTEs) flat over the IR term.[63] In Energy Probe's view, considering that both utilities themselves admit to having some form of a stretch factor in their current rates – on their third round of incentive regulation – this directly contradicts the evidence they are relying upon to have a zero percent stretch factor going forward.

45. PEG's evidence also paints a much different picture in terms of productivity at the two gas utilities and across the wider utility sector. For starters, the PEG report highlighted that the long-term trend for productivity growth in Dr. Makholm's study is positive, averaging 1.5% from 1973 to 2000. It only began to decline after 2000, which Dr. Lowry attributes to the long-term decline

[59] EB-2017-0306, Transcript Volume 4, page 12-18
[60] Fortis BC Inc., Multi-Year Performance Based Ratemaking Plan for 2014 through 2018, page 88
[61] EB-2017-0306, Transcript Volume 4, page 44
[62] EB-2013- 0202 Application and evidence, page 177
[63] EB-2017-0306, Transcript Volume 4, page 35

in average use – a trend that both Enbridge and Union have confirmed repeatedly in previous applications before the OEB.[64] Secondly, both companies have, according to Dr. Lowry, achieved "brisk OM&A productivity growth" over the long-term.[65] Given that most – if not all – of the merger savings in this application are related to OM&A, Energy Probe considers this an important consideration when setting a stretch factor.

46. And finally, PEG adjusted Dr. Makholm's data to account for the number of customers served, as opposed to volumes delivered, which has been declining for gas utilities across North America. This adjustment raised the Total Factor Productivity (TFP) trend to +0.85%, as opposed to the negative TFP factor in Dr. Makholm's study.[66]

47. And finally, the Board should discount the data used in Dr. Makholm's study – as well as many other productivity studies that come before this Board – as the underlying data often comes from the United States where most utilities remain on cost-of-service rate regulations. Dr. Lowry confirmed this during the oral hearing.[67] Using the productivity findings for utilities on cost-of-service, in Energy Probe's view, does a disservice to ratepayers in Ontario, as it understates the productivity potential at rate-regulated utilities.

COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Energy Probe worked with other intervenors throughout the process to limit duplication while ensuring that the record was complete

ALL OF WHICH IS RESPECTFULLY SUBMITTED

June 15, 2018

Brady Yauch, consultant to Energy Probe Research Foundation

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[64] IRM Framework for the Proposed Merger of Enbridge and Union Gas, page 26
[65] IRM Framework for the Proposed Merger of Enbridge and Union Gas, page 35
[66] IRM Framework for the Proposed Merger of Enbridge and Union Gas, page 33
[67] EB-2017-0306, Transcript Volume 4, page 157