



BY EMAIL and RESS

Mark Rubenstein
mark@shepherd rubenstein.com
Dir. 647-483-0113

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

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Our File: EB20170319

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2017-0319 – Enbridge RNG Enabling Program – SEC Submissions

We are counsel to the School Energy Coalition (“SEC”). Pursuant to Procedural Order No. 4, these are the submissions of the SEC on the application by Enbridge Gas Distribution Inc. (“Enbridge”) for approval of the service fees (rates) for its proposed Renewable Natural Gas (“RNG”) Enabling Program under section 36 of the *Ontario Energy Board Act, 1998* (“OEB Act”). The proposed program consists of two separate services, an Upgrading and Injection Service.

Overview

The proposed RNG Enabling Program is intended to provide services required to facilitate RNG production in Ontario. These services include the RNG Upgrading Service, which takes untreated raw biogas and turns it into pipeline quality RNG that can then be used by end-users in the same way they currently use traditional natural gas.¹ The service in turn takes this upgraded biogas, odorizes it and then inject into Enbridge’s pipeline system safety.² Once the upgraded biogas has entered the Enbridge system, the RNG producer can transport it on the system by way of the various transportation services that are currently offered.³

Enbridge proposes that the Injection Service be mandatory, as in their view they require exclusive control over the quality of gas that enters their system.⁴ In contrast, the Upgrading Service would be optional, because it is an activity that can be done by the producer itself (or a competitive third party).

The application when originally filed relied heavily on the existing Cap and Trade regime in place at the time, and the potential funding of RNG supply in Ontario through the Climate Change Action

¹ Exhibit B-1-1, para. 44-45

² Exhibit B-1-1, para. 44-45

³ Exhibit B-1-1, para. 50

⁴ Interrogatory Response I.1.EGD.Staff.1

Plan.⁵ Currently, the evidence is that Enbridge still has one potential customer that has already signed an agreement⁶ which based on publicly available information appears to be the City of Toronto.⁷

While the regulatory regime and government policy has now changed, if the services are designed correctly than it should not matter. Assuming existing customers are not bearing any of the costs and risk, the Board should allow Enbridge to offer any services which it is permitted to offer. Enbridge's evidence is that there is demand for these services, even absent potential government funding.⁸

Enbridge's application raises a number of important issues for the Board to consider regarding its jurisdiction and the proposed method in setting a methodology to determine project specific fees for the proposed services. SEC addresses these issues below.

Board's Jurisdiction (Issue 1)

SEC submits that the Board can only approve rates for the proposed Injection Service. The Board lacks the authority to regulate the rates for the Upgrading Service.

Section 36 of *OEB Act* does not provide the Board with authority to set rates for all activities undertaken by a gas company regulated by the Board, not even all activities involving gas. Section 36(2) provides that the "[t]he Board may make orders approving or fixing just and reasonable rates for the sale of gas by gas transmitters, gas distributors and storage companies, and for the transmission, distribution and storage of gas."⁹ The Board can therefore only set rates for activities related to the sale, transmission, distribution and storage of gas. It lacks the authority to set rates related to the production of natural gas.

SEC submits only the Injection Service falls within that rate-setting authority. The evidence is that RNG producers who inject into the Enbridge pipeline system will use existing Enbridge transmission and/or distribution services to move the gas along the system. It is an activity related to the transmission and distribution of gas and falls within the ambit of section 36 of the *OEB Act*.

The Upgrading Service is very different. The service involves taking raw untreated biogas and transforming it so that these molecules can come along with traditional natural gas molecules and ultimately used in the same way by the end user. In its raw state, biogas cannot be used by end users or be transmitted or distributed through the natural gas system as it still has impurities such as carbon dioxide, hydrogen sulfide, and nitrogen, among others. Until the upgrading process is complete, one has biogas, not RNG.¹⁰

⁵ Exhibit B-1-1, para 1-30

⁶ Technical Conference Transcript, p.25

⁷ <https://www.newswire.ca/news-releases/enbridge-and-city-of-toronto-to-build-one-of-the-first-renewable-natural-gas-facilities-in-ontario-688735061.html>

⁸ Technical Conference Transcript, p.4-5

⁹ *Ontario Energy Board Act, 1998*, s.36(2)

¹⁰ Interrogatory Response I.1.EGDI.EP.3(f)

The proposed Upgrading Service is simply another stage in the RNG production process.¹¹ The Board lacks the authority to regulate rates related to gas production.

In Quebec, the Régie de l'énergie ("Régie") came to the same conclusion regarding similar upgrading facilities proposed by Gaz Metro.¹² The Régie, in interpreting similar legislation, determined that those facilities are gas processing facilities, which are upstream of the distribution system and thus are unregulated.¹³ In reaching that conclusion, the Régie referred to a previous decision where it had determined that gas that was not in a physical state ready for consumption, is not a regulated activity.¹⁴ Non-upgraded RNG is similarly not ready for consumption.

This distinction is consistent with the purpose of the Board's role in regulating rates for monopoly services. The Upgrading Service, like other production activities, is not a monopoly activity. Enbridge has conceded that the Upgrading Service is something others - including the producer - can do and, because of that, it is an optional rather than required service.¹⁵

SEC does agree with Enbridge that it is still open for Enbridge to carry out the Upgrading Service within the utility. Although not rate regulated, it would meet the requirements of the Minister's 2006 Directive ("the Directive") to the Ontario Energy Board, which altered the application of the Enbridge undertaking to the Lieutenant Governor in Council ("Undertaking") regarding restrictions on business activities. Those restrictions as set out in the Undertaking provide that Consumers Gas (now Enbridge) cannot, except through an affiliate, carry on any business activity other than the transmission, distribution or storage of gas, except with the approval of the Board. The 2006 Directive provides that the restrictions in the Undertaking do not apply to services that would assist the Government of Ontario in achieving goals in energy conservation related to "promotion of cleaner energy sources, including alternative energy sources and renewable energy sources."¹⁶ SEC accepts that the Upgrading Service is intended to promote these types of energy sources.

The fact that Enbridge is permitted to provide the Upgrading Service within the utility does not mean that the rates for the service are to be regulated. The Directive, made under section 27.1 of the *OEB Act*, does not dictate whether any activity is rate-regulated. The Directive simply requires the Board withhold enforcement of the Undertaking restrictions regarding certain new business activities. It allows Enbridge to undertake the activity, which otherwise it would have had to do through an affiliate. It does not, nor could it, provide that the activity is or can be rate-regulated. Section 36 limits the Board's rate-setting authority to certain activities. All other services the utility is allowed to offer are to be treated as non-rate regulated. By way of example, the same company Union Gas has certain storage assets that are rate regulated, and others due to the Board's NGEIR decision that are not.

¹¹ Exhibit B-1-1, para 49 (JT1.1, Appendix D)

¹² Régie de l'énergie, D-2012-041 (R-3824-2012), para.77 (JT1.1, Appendix D)

¹³ Régie de l'énergie, D-2012-041 (R-3824-2012), para.77 (JT1.1, Appendix D)

¹⁴ Régie de l'énergie, D-2011-108 (R-3732-2010), para 24

¹⁵ Technical Conference Transcript, p.59, 157; JT 1.8; I.1.EGDI.STAFF.1(a)(iii)

¹⁶ Exhibit B-1-1, Appendix 1, p.12

Proposed Service Fees (Issue 2.1)

Enbridge is seeking approval for a rate-methodology for the fees of its proposed new services. The proposal is that for each individual project, a fixed monthly fee would be set to equal a PI of 1.02, consistent with the applicable parts of the EBO 188 methodology. What Enbridge is proposing is using a methodology that forecasts the revenue requirement of the service over the life of a given injection asset (which will be set as the length of the service contract), using parameters that are used in EBO 188 to do this analysis on discounted cash flow basis. Under the proposal, Enbridge then determines what a fixed monthly rate would need to be to ensure that, over the life of the asset/contract, it recovers the entire cost of providing the service.

As discussed under Issue 1, SEC submits the Board does not have the authority to set a fee for the Upgrading Service under section 36 of the *OEB Act*. All incremental costs and a fair allocation of shared service costs should be allocated to this new non-rate regulated service (in order to ensure that those costs are not unfairly borne by customers of regulated services), but at that point Enbridge is free to set whatever fee it feels is appropriate. Thus, in responding to Issue #2, SEC is providing submissions only on fees for the Injection service, since that is in our view the regulated activity in which the Board has rate-setting jurisdiction.

SEC notes that, if the Board disagrees with our view of its jurisdiction to regulate the Upgrading Service, there is still a significant issue relating to how the Board would set its fees. The same issues we have raised with respect to the Injection Service would apply there.

SEC understands the attraction for setting a fixed levelized service fee over the life of the contract from the perspective of potential RNG producers, rather than use a more traditional approach, which would be to divide the annual revenue requirement by 12 months. Since there will be relatively few customers, and the Injection systems are to be individually constructed for each customer, pooling of costs may not be a viable option. Because of that, setting the individual service fee using the traditional rate-making approach may result in high initial fees, since all of the assets are new, and then the costs would decline over the length of the contract as the asset depreciates. Distribution and transmission customers have the benefit of the pooling of assets in an individual rate class which will have a wide-range of vintages and thus act to moderate year over year rate changes.

The proposed rate-making approach is unique. No other rate class have their rates set on this basis, nor have rates been fixed for the life of any contract. SEC submits that the proposed rate-setting methodology is contrary to sound rate-setting principles, in three fundamental ways. First, it delegates the rate-setting process to Enbridge. Second, it fixes those rates for the life of the service contract, and thus unfairly transfers the forecast risk onto existing customers. Third, it does not include all relevant costs as inputs.

Setting Rates By Methodology. While SEC accepts that the Board's rate-setting methodology is broad, and includes in limited circumstances the ability to set a methodology as opposed to a specific amount¹⁷, it should not simply delegate this core function to the utility.

¹⁷ *Decision with Reasons* (EB-2012-0396 – NRG), February 14 2018, p.13; *Decision and Order* (Goldcorp - Union, EB-2014-0234), February 26 2015

The Board has never, to the best of our knowledge, purported to delegate the full calculation of a base unit rate to the regulated utility. In practice the Board has always retained for itself the ultimate responsibility for setting the dollar amount for any base rate for any class of customers. It may be a unit rate, and the units may be determined by the utility and the customer, for example with contract demand as in Rate 125. However, the dollar figure, and the basis for its calculation, is always determined by the Board in advance of the rate being charged. Under Enbridge's proposal the utility will, independent of the Board, do its own cost of service calculation over the life of the service contract, and then determine the fee that it will charge to its customer base to ensure that it recovers its forecast costs based on a proposed methodology.

SEC understands there are some unique aspects of the proposed Injection Service that may warrant an exception to the Board's general rate-making approach for setting ahead of time a defined numeric rate for all customers within the same rate class.. There are likely to be a minimal number of projects and the initial capital costs are site specific.

This may be the appropriate case for a narrowly defined exception. But it is insufficient for the Board simply to approve a methodology unless the inputs are easy to determine and uncontroversial, with no subsequent approval. It must also approve the application of the methodology.

Any approved methodology must be clear enough so that a) the Board is satisfied its application will result in just and reasonable rates (fees), b) Enbridge will know how it is to be applied, c) potential RNG producers will know that what is being presented to them is fair, and d) existing customers know that there is no cross-subsidy.

Enbridge's proposal does not provide the required clarity and simplicity to ensure that when its applied, it will lead to just and reasonable rates. While the evidence provides examples of the application of the proposed approach, what is being sought for approval in the Rate Handbook, is a rate based on "a cost-of-service calculation of the Company's fully-allocated direct and indirect costs using the Company's weighted average cost of capital ("WACC") of providing the services under the Agreement for a period of time agreed to between the Company and the Applicant."¹⁸ While the Biogas Agreement may provide some clarity regarding the facility construction costs¹⁹, there is nothing regarding how the direct and indirect costs are to be determined. Enbridge cannot be given full discretion to determine which costs are to be included and also how they are to be forecast. Otherwise the Board has no ability to ensure the methodology will lead to just and reasonable rates.

The Board should require Enbridge to bring forward an application for approval of the fees for each Injection Service project. The Board can devise a streamlined process to balance the need for oversight with regulatory efficiency. Having an approval process would ensure that the Board is retaining its oversight role in approving just and reasonable rates. Such a process ensures that Enbridge can easily develop a project specific fee, but also ensures that the Board is protecting the interest of not just the RNG producer, but also existing customers.

¹⁸ Exhibit B-1-Appendix 9, 10

¹⁹ Interrogatory Response I.1.EGD.Staff.6, Attachment 1, p.73

Fee Should Adjust Over-time. Enbridge is proposing that for this class of customers only, its rates (service fee) be fixed for the life of the facilities serving them (i.e. the duration of the service contract). The effect of this is to shift the risk of under-recovery of costs from the customers benefitting from the service – those of the Injection Service – to all the other customers, who do not benefit. Insofar as over the life of the service contract those forecasts are incorrect, the impact will fall on other distribution and transmission customers, not the customers of the Injection Service, or Enbridge.²⁰ No other Enbridge customer class is provided with 20 years of rate certainty.

To set the long-term fixed service rate, Enbridge must make a number of assumptions regarding the costs that will be incurred over a long time horizon. These costs include not just any required on-going capital and OM&A costs but also the forecast tax rates, and the cost of capital.²¹ In fact, because it is using the EBO 188 approach, it does not even forecast the assumptions, such as the tax rate and cost of capital. Those are simply fixed at the current rates. While this may be appropriate for the original purposes of EBO 188, it does not make much sense for cost of service rate-making.

Providing a long term rate guarantee, on the backs of the other customers, is not just and reasonable rate-making policy. If such a provision were appropriate, then customers in many other classes would also want similar protection. Large load customers are just as sensitive to future rate uncertainties, at least as much as customers of the Injection Service. If this approach is appropriate to provide rate certainty to an RNG producer, why is the same benefit not offered to any other transmission or distribution customer, such as a school board?

While Enbridge says that it will ensure that the PI will be greater than 1, that is somewhat misleading, as by definition using the methodology it proposes, it must have a PI of at least 1 or it has done the analysis incorrectly and not calculated the correct fixed monthly rate. In its Argument-in-Chief, Enbridge has proposed for the first time to build in a safety margin of 2% on a net present value basis (PI of 1.02).²² Such an amount cannot capture the forecast errors that would reasonably be expected in trying to forecast out direct on-going capital and operating costs for an activity Enbridge to date has no experience undertaking. SEC notes that the proposed PI of 1.02 differs from the example Enbridge provided in the evidence, which is based on a PI of 1.1 (10% safety margin).²³

The Board should require that the service fee be re-calculated and adjusted if required over time, similar to how all other customers have their rates change as costs increase (or decrease). The Board could require the Enbridge to update the forecast costs that make up the service fee calculation on a regular interval that matches when other customers have their costs adjusted on a cost of service or Custom IR basis. This could be at any Enbridge rebasing and potentially also other

²⁰ Technical Conference Transcript, p.185

²¹ For example, the EBO 188 DCF analysis discount rate is set based on the incremental after-tax cost of capital. In the examples provided, Enbridge has used the discount rate 5.43% which is based on its current Board approved debt/equity ratio, cost of debt and return on equity. (See I.2.EGDI.CBA.8)

²² Enbridge Argument-in-Chief, para 51

²³ Exhibit B-1-1, Appendix 7 p.2, Appendix 11, p.2

applications which seek material increases in cost (for example an ICM application under the proposed Enbridge-Union rate-setting framework).²⁴

While Enbridge may claim that RNG producers require some form of rate-certainty to determine the economics of the project beforehand, the same can be said for any energy intensive commercial or industrial business. In fact, the evidence is that a significant portion of the on-going costs of either Injection Service is that of other required utilities (i.e. electricity and water) that is being borne entirely by the producer.²⁵ For example, the services will require electricity, which is estimated to be about 30-40% of on-going operating costs.²⁶ Electricity costs are not fixed, and their rate of increase is far from predictable.

Any updates through the term likely would not transform the economics of the RNG producer's business, considering the largest input to the rate, the initial construction costs, would not change.

Proposed Methodology Does Not Allocate All Appropriate Costs. SEC is concerned that the methodology does not account for two major components. First, the methodology appears to assume that no additional capital costs will be incurred for the facilities over the life of the contract which, based on the examples in the evidence, could be 20 years. This is highly unlikely. There will likely be repairs for at least some of the facilities over their life, and some of work may be properly accounted for as capital costs.

Second, Enbridge's evidence is that "[t]he determination of the service fees for Injection Service will be site specific and based on the fully allocated costs associated with the services in each particular instance."²⁷ Yet, the examples it has provided in the evidence do not show fully allocated costing. Neither the capital nor OM&A costs that are forecast allocate any non-direct costs.

The forecast capital costs for the Injection Services include only the costs of the individual facility that is being constructed. It includes no indirect costs such as Enbridge's offices, vehicles, information technology or tools, a portion of which should be allocated to the service fee customers.

The lack of a fully allocated cost also appears to be the case for its forecast OM&A costs. In response to Board Staff Interrogatory 9, Enbridge provided the detailed OM&A costs built into its example project in the evidence.²⁸ Those costs appear to be direct OM&A costs only, and no portion of indirect shared costs, such as an appropriate share of executive compensation, corporate services and other similar cost categories. A portion of those costs should be allocated to RNG producers. In contrast, in the now withdrawn Geothermal Service proposal, the OM&A costs did include shared service costs such as 'Overhead and Management'.²⁹

Even if SEC is incorrect, and these shared services costs have been allocated, it is not clear what the basis of the allocation is, and whether it is appropriate. SEC requests Enbridge provide this

²⁴ See the Enbridge-Union EB-2017-0307 rate-setting application

²⁵ Technical Conference Transcript, p.183

²⁶ *Ibid*

²⁷ Exhibit B-1-1, para 44

²⁸ I.2.EGDI.STAFF.9(l)

²⁹ See Interrogatory Response I.2.EGDI.STAFF.14(f)

information and rationale for it in their Reply Argument. The cost allocation principle for these costs must be transparent, so that for any given project, both new and existing customers understand how Enbridge proposes to allocate costs.

Summary. SEC submits that the Board has the authority to set the service fee methodology for the proposed Injection Service only. In doing so, it should not accept the proposed approach which delegates too much authority to Enbridge, fixes the fees for an inappropriate length of time, and does not include all relevant costs.

The Board should ensure the approved methodology clearly outlines which costs that should be included in the calculation. It should then require Enbridge to bring forward for approval the proposed final fees it intends to charge based on that methodology for a given project. This will allow the Board to conduct a review, which can be done through a streamlined regulatory process to ensure the fee is just and reasonable.

The Board should also require that Enbridge update the rate calculation during the length of the service contract each time it sets cost of service (or Custom IR) rates for other customer classes so that any changes in the forecast costs are reflected in rates. Adjusting the fee for changes in forecast costs ensures that existing customers do not bear the forecast risk for a service they are not benefiting from.

Appropriate Terms and Conditions (Issue 2.3)

The largest risk that existing customers face, regardless of the rate methodology that is employed, is the cost that may be attributed to them if an Injection Service customer defaults, and there are stranded costs associated with the facilities. Considering the large initial capital, and the nascence of the RNG market, the default risk is higher than would otherwise be the case.

Enbridge's proposed model service contract (the Biogas Services Agreement), includes a provision that requires a customer to provide financial assurance if Enbridge requests.³⁰ Under that agreement a financial assurance can be requested "based on the creditworthiness of the customer and shall be consistent with the company's then current policies relating to customer account security applicable to like customers".³¹ The problem is that Enbridge does not have a written policy that can be reviewed to ensure that it is appropriately protecting existing customers.³² Enbridge simply makes that decision on a case-by-case basis based on the size of investment and the counterparty.³³

SEC agrees with Enbridge that there is little risk of public sector entities, which are most likely municipalities, from ever defaulting on their service contract.³⁴ However, here there could be a significant risk from private parties. Since there is no formal policy to assess, all Injecting Service customers should be required to provide Enbridge with sufficient financial assurance to ensure ratepayers are not bearing the cost of any potential default.

³⁰ Interrogatory Response I.2.EGDI.SEC.16(b)

³¹ Interrogatory Response I.2.EGDI.Staff.6, p.15, section 13.02

³² Technical Conference Transcript, p.195; JT1.15

³³ JT1.15

³⁴ Technical Transcript, p.196



In response to Undertaking JT 1.15, Enbridge stated that it did not believe any such provision was necessary as it does not believe it should treat customers of these services any differently from existing large volume customers.³⁵ SEC submits that Enbridge has little experience trying to determine the creditworthiness of an entity that is undertaking an activity (producing RNG) that does not exist in Ontario at this time.

Yours very truly,
Shepherd Rubenstein P.C.

Original signed by

Mark Rubenstein

cc: Wayne McNally, SEC (by email)
Applicant and Interested Parties (by email)

³⁵ Ibid