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Ontario

BY E-MAIL

October 30, 2018

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4
BoardSec@oeb.ca

Dear Ms. Walli:

Re: OM Limited Partnership
Application for rate order, price cap setting mechanism, and interim rate commencing September 1, 2018
OEB Staff Submission
OEB File No. EB-2018-0234

Please find attached OEB staff's submission in the above referenced matter in accordance with Procedural Order No. 1 issued September 25, 2018.

Yours truly,

Original signed by

Ritchie Murray
Project Advisor

cc. (by email):
Scott Lewis, slewis@tributeresources.com
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Ontario

ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION

OM Limited Partnership

EB-2018-0234

Distribution Rate Application

October 30, 2018

Introduction

OM Limited Partnership (OMLP) filed an application with the Ontario Energy Board (OEB) on August 13, 2018 under section 36 of the *Ontario Energy Board Act, 1998* (Act), for an order or orders approving a distribution rate to supply its locally produced natural gas to a new greenhouse facility owned and operated by its affiliate Maricann Group Incorporated (Maricann), effective September 1, 2018 (application). The evidence incudes a letter from Maricann stating that it has reviewed and supports the application.

On September 19, 2018, the OEB approved OMLP's rate as proposed on an interim basis, effective September 19, 2018. The interim rate is equivalent to the proposed final rate.

In its application, OMLP requested the OEB to use the cost of service (or revenue requirement) method to approve or fix the just and reasonable rates for the test year and proposed a price cap incentive rate-setting (IR) model for the four years following the test year. The test year is the 12-month period beginning the date of commencement of service to the customer.[1] OMLP estimates first gas delivery to commence on November 5th, 2018.[2]

Maricann is a direct purchase customer of OMLP. This means that OMLP only provides a gas distribution service to Maricann. Maricann will procure its gas supply from its other affiliate, ON Energy.

OMLP proposed the following list of issues:[3]

1. Are each of the components of the proposed revenue requirement appropriate and calculated correctly?
2. Is the proposed rate design appropriate?
3. Is the proposed Price Cap IR Plan appropriate?
4. Is the resulting rate just and reasonable?
5. Is the request for an exemption to the Affiliate Relationships Code for Gas Utilities appropriate?

[1] Exhibit 1, Tab 2, Schedule 1, page 2.
[2] OEB staff interrogatory #2.
[3] Exhibit 1, Tab 3, Schedule 1, page 5.

6. Is the request for an exemption in whole to the Gas Distribution Access Rule appropriate?

OEB staff's submission is organized according to this issues list.

Revenue Requirement

OEB staff submits that the proposed revenue requirement is appropriate.

Table One (below) provides a breakdown of the revenue requirement for the test year. The revenue requirement for the test year is $268,220 based on a rate base of $692,620[4] which leads to a total weighted average cost of capital of $22,441. Operating, Maintenance & Administration (OM&A) expenses of $210,829, depreciation of $34,473 and income taxes of $477. OMLP proposes a rate that will allow it to recover this revenue requirement. OMLP is proposing a ROE of 9% for the entire 5 year period

Table One: Test Year Revenue Requirement[5]

	($'s)	Revenue Requirement
Rate Base		
Test Year Average Rate Base	692,620	
Test Year Requested Rate of Return	3.24%	
		22,441
Cost of Service		
Operation and Maintenance	210,829	
Depreciation and Amortization	34,473	
		245,302
Income Taxes		
Income Taxes on Earnings	477	
Income Taxes on (Deficiency/Sufficiency)	0	
		477
Revenue Requirement		268,220
Disrtribution Revenue	268,220	
Rounding Adjustment	0	
		-268,220
Gross Revenue (Deficiency)/Sufficiency		0

[4] All assets required to serve Maricann have been constructed and no additional assets are forecasted for the test year.
[5] Exhibit 6, Tab 1, Schedule 4

OMLP has not filed any benchmarking evidence as part of its application. OMLP states it is not aware of any comparator groups against which it could be measured. OEB staff is also not aware of any such comparator groups.

OEB staff has examined the inputs and methodology used to calculate the revenue requirement (including a series of clarifying questions regarding capital and OM&A expenses that contribute to the revenue requirement[6]). Based on OMLP's evidence and responses to interrogatories, OEB staff concludes that the revenue requirement is appropriate.

Rate Design

OEB staff submits that the rate design is appropriate in this case.

The application indicated that the proposed rate framework arose through an agreement between OMLP and its customer, Maricann.

OMLP is proposing a simplified rate design that consists of a fixed charge of $22,352 per month. The monthly rate is equal to one-twelfth of the total annual revenue requirement of $268,220. In the absence of any Z or Y-factor (described below), the rate charged would remain unchanged over the five-year IR term. OMLP proposes that it would not file an annual rate application unless requesting a Z or Y-factor. OMLP is not requesting any deferral and variance accounts.

Price Cap IR

OEB staff submits that the proposed Price Cap IR plan is appropriate in this case.

OMLP has proposed a five-year term for the Price Cap IR plan. The first year would be a cost of service test year beginning September 1, 2018, and followed by four years that reflect a price cap index (I-X). OMLP is not requesting a capital module.

The X-Factor has two parts: a productivity factor and a stretch factor. OMLP proposes that the X-Factor (productivity factor plus stretch factor) be set equal to the inflation factor (I) to ensure that OMLP provides productivity improvements to offset cost increases due to inflation. OMLP proposes to use the Gross Domestic Product Implicit Price Index Final Domestic Demand (GDP IPI FDD) as the inflation factor. OEB staff

[6] OEB staff interrogatory #8-#12.

submits that the use of GDP IPI FDD is consistent with OEB policy[7] and that the use of an X-Factor provides an incentive.

OMLP proposes that a Z-factor mechanism be available to it in order to address material cost increases or decreases associated with unforeseen events outside of the control of management. In accordance with OEB policy, OMLP proposes that the four criteria of causation, materiality, prudence and management control be applicable.[8] With respect to the materiality threshold, OMLP proposes a threshold equal to 10% of its approved revenue requirement. This would limit the potential number of Z factor events for recovery, while providing OMLP the opportunity to recover costs that would represent a significant portion of its costs. OMLP would promptly notify the OEB of any Z-Factor event. OMLP suggests that Z-factors could include changes in statutes, regulations, tax rates and/or CCA rates.[9]

In its application, OMLP states it is not proposing any capital factor component in its Price Cap IR plan.[10] It is unclear to OEB staff whether OMLP intended to state that it is not proposing any capital factor component *at this time*. The reason for the uncertainty is that, consistent with OEB policy, OMLP proposes that a Y-factor mechanism be available to it in order to pass through any costs that are incremental to the test year period and incurred during the IR period.[11] OMLP suggests that Y-factors that could be applicable to its operations include capital expenditure costs for system safety and integrity and one-time billing adjustments.[12] It is possible that OMLP could apply for a capital factor (i.e., incremental capital module or ICM) to manage these costs. OEB staff notes that any potential Y-Factor and/or capital factor would require an application to and approval of the OEB.

OMLP notes that it is a new utility, serving one customer, and the facilities required to serve the customer have been included in the test year rate base. No significant capital investments are expected in years two through five of the plan.

Consistent with OEB policy, OMLP proposes to include in its Price Cap IR plan a trigger mechanism with an annual regulatory return on equity (ROE) dead band of +/- 300 basis points.[13] If OMLP's regulatory financial performance is outside of this earnings dead band, a regulatory review may be initiated. OMLP further proposes than any such

[7] *Filing Requirements for Natural Gas Rate Applications* dated February 16, 2017.
[8] Ibid.
[9] OEB staff interrogatory #7.
[10] Exhibit 10, Tab 1, Schedule 1, page 3.
[11] *Filing Requirements for Natural Gas Rate Applications* dated February 16, 2017.
[12] Ibid.
[13] Ibid.

review would be prospective in nature, and could result in modifications, termination or the continuation of the Price Cap IR plan.

OEB staff submits that OMLP's proposed Price Cap IR plan is consistent with OEB policy, and provides a suitable level of protection for Maricann and OMLP.

The Rate

OEB staff submits that the proposed rate is just and reasonable.

The application states that Maricann has been engaged with OMLP since its inception, and that "[t]he OMLP system was designed specifically to meet Maricann's demand requirements and service preferences. Maricann has reviewed the draft application and evidence related to this proceeding and have indicated that they accept the proposed rate that results from the application."[14] OMLP asserts that because the rate framework arose through mutual agreement, it is therefore "just and reasonable".

OEB staff has examined the revenue requirement, rate design and Price Cap IR plan and found them to be appropriate. Given these findings and that the Maricann (an affiliate of OMLP) has agreed to the rate, OEB staff submits that the rate is just and reasonable.

Exemption Requests

OMLP has requested blanket exemptions from both the *Affiliate Relationships Code for Gas Utilities* (ARC) and the *Gas Distribution Access Rule* (GDAR). OEB staff notes that this application is somewhat unusual for two reasons. First, OMLP will only have a single customer and has stated that it has no intention (or, given its limited franchise territory even the ability) to serve any additional customers. As discussed further below, this is relevant to the GDAR exemption request. Second, OMLP is affiliated with both its only customer (Maricann), and the company from which it will receive most of its O&M services (ON-Energy). Maricann and ON-Energy are also affiliated with each other. As discussed further below, this is relevant to the request for an exemption from the ARC.

Subject to the comments below, OEB staff do not oppose the exemption requests. However, OEB staff believes that the record on these issues would be more clear if OMLP specified clearly which sections of the ARC and GDAR they believe apply and they require an exemption from, and which sections of the ARC and GDAR they believe

[14] Exhibit 1, Tab 6, Schedule 1, page 1.

simply do not apply – in other words to provide a list of the sections from which an exemption is actually required. OEB staff requests that OMLP provide such a list with their reply submission. After receiving this list the OEB may choose to require further process to ensure that only the exemptions that are actually required and appropriate are granted. As OMLP already has an interim rate order, any additional process should not lead to any delays in actually serving Maricann with gas.

Affiliate Relationships Code

OMLP has requested an exemption in whole from the ARC. OEB staff has no objection to the OEB granting this request for the reasons given below. However, OEB staff notes that the exemption may no longer be valid if OMLP were to add one or more additional customers.

The ARC sets out the standards and conditions for the interaction between gas distributors, transmitters and storage companies and their respective affiliated companies. The principal objectives of the ARC are to enhance a competitive market while, at a minimum, keeping ratepayers unharmed by the actions of gas distributors, transmitters and storage companies with respect to dealing with their affiliates.

In its application, OMLP asserts that an exemption from the ARC is warranted because, "OMLP is limited in its operation and as such will not have its own employees and accounting services and will rely on ON-Energy Corp. to provide these services. ON-Energy is a partner in OMLP and owns and controls a substantial portion of the partnership."[15]

Union Gas asked why article 2.2 of the ARC is not relevant to OMLP, given that OMLP and ON-Energy may each have access to non-public information.[16] In part, article 2.2 states, "Where a utility shares services or resources with an affiliate it shall do so in accordance with a Services Agreement, the length and terms of which may be reviewed by the Board to ensure compliance with this Code." The article also states, "Where a utility shares information services with an affiliate, all confidential information must be protected from access by the affiliate." OMLP responded that given that OMLP and ON-Energy may each have access to non-public information, article 2.2 is not relevant because Maricann will have access to this information through partial ownership of OMLP.

[15] Exhibit 4, Tab 2, Schedule 5, page 1.
[16] Union Gas interrogatory #2 b.

OEB staff agrees that an exemption from article 2.2 is appropriate in this particular case. Maricann, OMLP, and ON-Energy are all related companies. There therefore does not appear to be any concern about OMLP sharing confidential information about Maricann with ON Energy. For similar reasons OEB staff does not believe that a formal Services Agreement is necessary between OMLP and ON Energy. As Maricann is OMLP's only customer, and as it is a related company to both OMLP and ON Energy, there does not appear to be an opportunity for "mischief" in OMLP receiving services from its affiliate ON Energy. Any overcharging for services by ON Energy would ultimately be paid by its own affiliate Maricann.

Union Gas asked why article 2.3.9 of the ARC is not relevant to OMLP.[17] Article 2.3.9 states, "Where a reasonably competitive market exists for a service, product, resource or use of asset, a utility shall charge no less than the market price of the service, product, resource or use of asset when selling that service, product, resource or use of asset to an affiliate." Article 2.3.9 A states in part, "For a service, product, resource or use of asset that pertains exclusively to the ownership and operation of one or more qualifying facilities, fully-allocated cost-based pricing (as calculated in accordance with section 2.3.10 or 2.3.11) may be applied between a utility and an affiliate in lieu of applying the transfer pricing provisions of section 2.3.4 or section 2.3.9." OMLP responded that ON-Energy will be providing services to a separate and related company and that the relationship is not simply a cost allocation exercise. As such, article 2.3.9 of the ARC is not relevant as OMLP is "right at market" with the gas it is providing to Maricann and as such OMLP believes ON-Energy is charging a competitive market price for that gas.[18]

Section 2.3.9 requires that, where a competitive market exists, a utility shall charge no less than the market price for the service. In the current case, the "utility" is OMLP, which is the gas distributor. Maricann is not purchasing gas from OMLP – it is purchasing its gas directly from ON Energy. ON Energy is not a utility and is not covered by section 2.3.9 of the ARC. OEB staff submits that this portion of the ARC does not apply and an exemption is not necessary. It is also not clear what incentive ON Energy would have to overcharge Maricann, as Maricann is its affiliate.

OMLP has indicated that it does not foresee providing gas service to additional customers in the future using the facilities constructed to serve Maricann.[19] OMLP has further confirmed that it is aware that if the OEB were to approve a request for an

[17] Ibid.
[18] Union Gas interrogatory #2 b.
[19] OEB staff interrogatory #1.

exemption in whole from the ARC, that such exception may no longer be applicable in the event that OMLP were to begin serving one or more additional customers.[20]

OEB staff submits that if OMLP were to add one or more additional customers, an exemption from ARC may no longer be valid. For example, if adding additional customers necessitates the hiring of employees by OMLP, then the OEB may determine that an exemption to the ARC does not provide sufficient protection to prevent confidential information from being accessed by the affiliate.

Gas Distribution Access Rule

OMLP has requested an exemption in whole from the *Gas Distribution Access Rule* (GDAR). OEB staff has no objection to the OEB granting this request subject to a limited amount of reporting requirements being imposed by the OEB. Further, OEB staff notes that the exemption would no longer be appropriate if OMLP were to add one or more additional customers.

The GDAR establishes a number of performance standards and measurements for the natural gas industry in Ontario. These service quality requirements includes telephone answering performance, billing performance, meter reading performance, service appointment response times, gas emergency response, customer complaint (written) response and disconnection/reconnection. GDAR also deals with the establishment of conditions of access to gas distribution services provided by a gas distributor and establishes rules governing the conduct of a gas distributor as such conduct relates to a gas vendor.

In its evidence, OMLP asserts that an exemption from the GDAR is warranted because, "OMLP has only one customer and that customer is a limited partner in OMLP. As a result, OMLP will be aware of any service quality issues directly from the customer/limited partner. Gas purchased by the customer will be from an affiliate of OMLP, as the distribution system is only connected to the natural gas wells and associated production and gathering pipelines of the affiliate." OMLP proposes no reporting except every five years and only if a rate adjustment is sought.[21]

OEB staff submits that compliance with the GDAR in full is unnecessarily burdensome in this particular case. However, as described in the section below, OEB staff submits that OMLP should be required to file an annual report with the OEB. Some of these

[20] OEB staff interrogatory #3.
[21] OEB staff interrogatory #6.

proposed conditions would assist the OEB in confirming each year that the application of GDAR remains unnecessary.

OEB staff submits that if OMLP were to add one or more additional customers, an exemption from GDAR may no longer be appropriate. For example, if a customer were added who is not an affiliate of OMLP, the OEB may determine that the performance standards and requirements of GDAR would apply.

Proposed Conditions

Given the unusual circumstances of this application, OEB staff recommends that OMLP should be required to file an annual report with the OEB. The report need not be onerous and could include status updates on such items as the following:

a) Identification of any potential customers that OMLP intends to serve using the facilities constructed to serve Maricann (Facilities).
b) Identification of any requests for service that OMLP has received.
c) A summary table of OMLP's planned versus actual ROE for each year of the five year IR plan (as applicable) with variance explanations.
d) A summary table of annual volumes delivered to Maricann for each year of the five year IR plan (as applicable) with variance explanations.
e) A summary table of Z-Factors and Y-Factors that OMLP has or may request approval of for each year of the five year IR plan (as applicable) with brief rationale for each.
f) A brief description of any pending capital projects associated with the Facilities (e.g., purpose, cost, timing and whether a Y-Factor may be requested).
g) A description of any orders or fines imposed by an authority having jurisdiction other than the OEB (e.g., the Technical Standards and Safety Authority) and relating to the Facilities.
h) Each year of the five year IR plan, a set of audited financial statements and trial balance per the OEB's *Uniform System of Accounts for Class A Gas Utilities*.[22]

OEB staff also submits that, on a quarterly basis, and using the OEB's e-Filing Services[23] to do so, OMLP should be required to report actual gas volumes delivered to Maricann.

[22] https://www.oeb.ca/documents/GasUSO.htm
[23] https://www.oeb.ca/industry/tools-resources-and-links/e-filing-services

Finally, OEB staff submits that, as a one-time filing, OMLP should be required to file an organizational chart illustrating the corporate structure and ownership positions of OMLP and its affiliates.

Conclusion

OEB staff submits that OMLP's application should be approved as filed with the exception that the OEB should impose a certain reporting requirements as listed above.

All of which is respectfully submitted.