ONTARIO ENERGY BOARD

STAFF SUBMISSION ON SETTLEMENT PROPOSAL FILED ON NOVEMBER 21, 2018

EPCOR Natural Gas Limited Partnership
2016, 2017 and 2018 Rate Adjustments & Other Matters
EB-2018-0235

December 3, 2018

Background

EPCOR Natural Gas Limited Partnership (EPCOR) is a privately owned utility regulated by the Ontario Energy Board (OEB) that sells and distributes natural gas in southwestern Ontario. EPCOR supplies natural gas to Aylmer and surrounding areas to approximately 8,800 customers.

In November 2017, EPCOR purchased all the distribution assets from the predecessor distributor, Natural Resource Gas Limited (NRG). In August 2016, NRG had filed a cost of service and IRM application for the period October 1, 2016 to September 30, 2021.[1] In Procedural Order No. 1 of that application, the OEB declared existing rates to be interim effective October 1, 2016.

After the interrogatories were filed in the cost of service application, NRG submitted a letter on November 16, 2016, informing the OEB that it had signed an asset purchase agreement with EPCOR to transfer NRG's natural gas distribution system in its entirety to EPCOR. Consequently, NRG requested the OEB to place its rates application on hold pending the outcome of NRG's application to the OEB requesting approval to transfer the assets to EPCOR.

NRG also informed the OEB that on receiving OEB approval to transfer the assets and associated rate orders to EPCOR, it would assume responsibility for the rates application and would file an amended application within six to nine months of closing the Asset Purchase Agreement.

In a letter dated January 30, 2017, the OEB approved NRG's request to place the rates' application[2] in abeyance pending the OEB's decision on the asset transfer application. The OEB approved the transfer of assets application on August 3, 2017 and the transaction to purchase the distribution system of NRG closed on November 1, 2017. NRG's rate order was also transferred as part of the transaction. NRG's August 2016 rates application is still in abeyance, and the interim rate order effective October 1, 2016 is still in effect.

Summary of the Proceeding

EPCOR Natural Gas filed an amended application on July 30, 2018 under a new file number requesting an incentive rate-making (IR) adjustment based on the OEB's 4th

[1] EB-2016-0236
[2] EB-2016-0236

Generation IR guidelines[3] for the period October 1, 2016 to December 31, 2019. In addition, EPCOR requested:

- Disposition of the Purchased Gas Transportation Variance Account (PGTVA), the Regulatory Expense Deferral Account (REDA) and the IFRS Conversion Cost Deferral Account (IFRSDA).
- Approval of a Fixed Monthly Charge for Rate 6, which includes only one customer, Integrated Grain Processors Co-operative Inc. (IGPC).
- Change to the start of the rate year, from October 1 to January 1 starting in January 1, 2020.

A Notice of Hearing was issued on August 23, 2018 and was served and posted as per the direction of the OEB. IGPC Ethanol Inc. and Integrated Grain Processors Co-operative (collectively, IGPC), Union Gas Limited (Union Gas) and Vulnerable Energy Consumers Coalition (VECC) applied for and were granted intervenor status.

The OEB in Procedural Order No. 1 issued on September 19, 2018, made provision for filing of interrogatories, responses to interrogatories, submission of a proposed issues list and scheduled a settlement conference with the objective of reaching a settlement among the applicant and the intervenors (the parties) on the issues. In a subsequent procedural order, the OEB amended some of the dates and scheduled an earlier settlement conference. The OEB scheduled December 11, 2018 for EPCOR to present any settlement proposal and a summary of the unsettled issues in the proceeding.

OEB staff submitted a proposed Issues List to the OEB that was agreed to by all the parties on October 29, 2018. The OEB in a decision issued on November 2, 2018 accepted the proposed Issues List.

A settlement conference was held on November 5 and 6, 2018 at the OEB. The settlement conference was attended by representatives from EPCOR, OEB staff, IGPC and VECC. Union Gas did not participate in the settlement conference and is not a party to the settlement proposal. Union Gas has also not supported or opposed the settlement proposal filed by the parties.

A settlement was reached on all issues in the proceeding. EPCOR filed the settlement proposal on November 21, 2018.

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[3] *Renewed Regulatory Framework for Electricity Distributors: A Performance Based Approach*, Report of the Board, October 18, 2012.

EPCOR Settlement Proposal

OEB staff has reviewed the settlement proposal filed by EPCOR in the context of applicable OEB policies and the OEB's statutory obligations. OEB staff supports the settlement of the issues and is of the opinion that the settlement is in the public interest. OEB staff has also reviewed the draft rate order and accounting order that was filed with the settlement proposal. OEB staff is largely satisfied with the proposed adjustments and the calculation of rates flowing from the agreement.

OEB staff is also of the view that the accompanying explanations and rationale, although not detailed, are adequate to support the settlement proposal. OEB staff offers the following additional commentaries on the settlement proposal that provides context to some of the issues discussed in the document.

OEB Staff Comments

The focus of the settlement proposal was on a few specific items and these are the areas that are further explained or elaborated below. The submission does not follow the issues list but discusses the larger issues in general.

Rate Adjustment for the Period October 1, 2016 to December 31, 2019

As noted earlier, the current rates of EPCOR are interim. The settlement proposes to make the rate adjustments final. Although the settlement notes that there are no rate adjustments for 2016 (October 1, 2016 to September 30, 2017) and 2017 (October 1, 2017 to September 30, 2018), this is likely referring to the fact that there will be no bill adjustments for this period.[4] The proposed rate adjustments for 2016 and 2017 have been accepted as proposed but there is no rate recovery for that period. Essentially, EPCOR is foregoing the proposed revenue recovery for adjustments related to the 2016 and 2017 rate years. However, the proposed rate adjustment for the period October 1, 2018 to December 31, 2019 has been accepted by the parties. In other words, the 2018 rates that are layered on to the rate adjustments of 2016 and 2017 will be implemented as proposed. This is noted on page 10 of the settlement proposal that states, "The new rates for October 1, 2018 are those that would have been calculated had rates been adjusted for the two prior years." OEB staff supports the settlement reached on this issue as the foregone revenues represent a saving of approximately $370,000[5] for customers of EPCOR.

[4] Settlement Proposal, pgs. 6-7
[5] Response to VECC IR#5

The parties accepted the proposed inflation rates (Input Price Index), productivity factor and stretch factor to reflect the rate adjustments for 2016, 2017 and 2018. In Phase 2 of NRG's 2011 cost of service proceeding, a settlement agreement was reached between NRG and intervenors whereby rates after rebasing were set using the incentive ratemaking framework adopted for electricity distributors.[6] EPCOR has continued that approach and in this application proposed to use OEB's 4th Generation IR guidelines. In its IR application, NRG proposed to use the electricity IRM model as it was familiar to the OEB and intervenors and given NRG's limited resources and small customer base, it was considered practical. NRG also noted in that application that in terms of revenues, customer count and other features it was more like other smaller electricity distributors as compared to Union Gas or Enbridge Gas Distribution.[7]

EPCOR has continued to follow the electricity IR model in this proceeding. Although OEB staff prefer that gas utilities should follow an IR framework similar to other gas utilities, OEB staff has no specific concerns with the approach agreed to in the settlement considering that the gas and electricity IR frameworks are not significantly different. Further, OEB staff has no concerns with the numbers used to reflect the IR adjustments. EPCOR has used the OEB issued Input Price Index applicable to electricity distributors for each of the years and the OEB recommended productivity factor of zero.[8] The stretch factor selected for the adjustment is 0.3% which is the mid-range for electricity distributors.[9] The previous IR framework of NRG included a 0.1% adder as per the settlement agreement[10] which EPCOR has used in its proposed adjustment to arrive at a stretch factor of 0.4%.

EPCOR has calculated a rate rider to recover the revenues for the period October 1, 2018 to December 31, 2018 as a rate order is likely to be approved effective January 1, 2019. OEB staff acknowledges that the rate rider has been calculated appropriately.

Increase to the Fixed Charge

The parties agreed to make an adjustment to the proposed rate design. For rate classes 1 to 5, it was agreed to increase the fixed monthly charge by 15% and make corresponding adjustments (reductions) to the variable charges. The current fixed

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[6] NRG 2011 Rates Application, Phase 2 Settlement Agreement, EB-2010-0018, November 11, 2011, pg.5
[7] NRG Phase 2 Revised Application, Exhibit H1, Tab 1, Schedule 2, pg.2, May 6, 2011
[8] Filing Requirement for Electricity Distribution Rate Applications – 2016 edition for 2017 Rate Applications, Chapter 3 Incentive Rate-Setting Applications, July 14, 2016, pg. 7
[9] ibid
[10] NRG 2011 Rates Application, Phase 2 Settlement Agreement, EB-2010-0018, November 11, 2011, pg.5

monthly charge for Rate 1 (includes residential) is $13.50 and this has been increased to $15.50 (rounded off after a 15% adjustment).

In NRG's cost of service application[11], the fixed monthly charge was proposed to be increased to $18.50. The change in the fixed monthly charge was proposed to bring it in line with the current fixed monthly charge of Union Gas which is $21.00 per month for Union Gas South residential customers. The fixed monthly charge for residential customers of Enbridge Gas Distribution is $20 per month.

The change in the fixed monthly charge to $15.50 will smoothen the additional increase that may arise from EPCOR's proposed change in the next cost of service application for 2020 rates. Although an increase in the fixed monthly charge has a larger impact on low volume customers[12], OEB staff supports the proposed change as it acknowledges that NRG's fixed monthly charge has not been changed for the past seven years. NRG last changed the fixed monthly charge in 2011 when the charge for residential customers was increased from $11.50 to $13.50.[13]

Rate Class	Current	EB-2016-0236	Settlement Proposal
Rate 1	$ 13.50	$ 18.50	$ 15.50
Rate 2	$ 15.00	$ 20.00	$ 17.25
Rate 3	$ 150.00	$ 175.00	$ 172.50
Rate 4	$ 15.00	$ 15.00	$ 17.25
Rate 5	$ 150.00	$ 175.00	$ 172.50

Adjustment to Reflect Depreciated Value of IGPC Pipeline in Rate Base

IGPC is a large ethanol producer in EPCOR's franchise area and is served through a dedicated steel pipeline. IGPC is served under Rate Class 6 and is the only customer in this rate class. In NRG's 2011 cost of service proceeding[14], the amount of the IGPC pipeline closed to rate base was $4,872,182.[15] This is the amount that has been used to calculate the depreciation expense and the cost of capital in rates, and derive rates for Rate Class 6. The total rate base approved in the same proceeding was $13,685,036.[16] The cost of the IGPC pipeline in rate base has remained the same since 2011 although the net book value of the pipeline has declined significantly over the past seven years.

[11] EB-2016-0236
[12] A typical residential customer will see an increase of 7.6% on total bill as a result of the settlement proposal
[13] EB-2010-0018
[14] EB-2010-0018
[15] Reply comments on Draft Rate Order, EB-2010-0018, January 18, 2011, pg.2
[16] NRG Draft Rate Order, Attachment G, December 29, 2010

The total net book value of the IGPC pipeline as of October 1, 2016 (the start of the rate year as per NRG's 2016 cost of service proceeding currently in abeyance) was \$2,894,423.[17] This change represents a decline of almost \$2.0 million in the net book value of the IGPC pipeline. However, the proposed total rate base for 2016 in that application was \$13,601,543[18] which is a reduction of \$83,493 over the 2011 OEB approved amount. In other words, although the rate base related to IGPC has declined by \$2.0 million in 2016, the proposed rate base for other rate classes has increased by a similar amount considering that the total rate base has largely remained unchanged from 2010 to 2016. Had its rates been updated pursuant to the cost of service application filed in 2016, IGPC's rates would have gone down on account of the lower rate base and cost of capital associated with the asset. As a result, in NRG's 2016 cost of service proceeding, NRG proposed to provide a relief of \$252,384 in rates to IGPC.[19]

In the settlement proposal, parties have proposed to provide relief to IGPC to recognize the relief that IGPC would have been provided if NRG's 2016 rates had been rebased. The parties have accepted a rate rebalancing under which IGPC will receive \$210,000 from rate classes 1-5. In addition, EPCOR will provide a further reduction of \$160,000 to IGPC through a rate adjustment. For the amount that rate classes 1 to 5 will contribute, EPCOR has proposed to set up a deferral account to facilitate the transfer from rate classes 1-5, to Rate Class 6. The \$370,000 (\$210,000+\$160,000) adjustment will be implemented as per the settlement proposal over the 2019 rate year (January 1, 2019 to December 31, 2019). The rate rebalancing is just for the 2019 rate year and will not be carried forward to future rate years.

OEB staff acknowledges the fact that IGPC has been paying more through rates over the past three years than required had the 2016 cost of service application been processed. OEB staff is of the view that it is not fair to IGPC to wait further until 2020 to receive the appropriate relief. In a sense, other rate classes have benefitted from the contributions of IGPC since at least 2016. Considering that the proposed rate base for 2016 was not significantly different from the rate base currently underpinning rates, the proposed relief for IGPC in 2016 would have largely been recovered from other rate classes. Had NRG rebased in 2016, other rate classes (1 to 5) would have been allocated a majority of the proposed reduction to IGPC's rate and would have paid over \$750,000[20] over the three year period (2016, 2017 and 2018). This is because the

[17] EB-2016-0236, Fixed Asset Continuity Schedule, pg. 7
[18] EB-2016-0236, Exhibit 2, Tab 1, Schedule 1, pg. 1
[19] Response to IGPC IR#5
[20] \$252,384 reduction in 2016 rates x 3 years = \$757,152

proposed revenue requirement for 2016[21] was higher than the 2013 OEB-approved revenue requirement of NRG and the proposed rate base for 2016 remained largely unchanged from that approved for 2011.

OEB staff supports the proposed rate rebalancing as it is an overdue adjustment to IGPC's rates and other rate classes would have paid a much higher amount in rates had the rates been rebased in 2016 as opposed to the adjustment in the settlement proposal ($210,000 as compared to $750,000). OEB staff further notes that EPCOR is foregoing rate recovery related to adjustments for the 2016 and 2017 rate year as per the settlement proposal which is a saving of $272,000 for rate classes 1 to 5.[22]

Parties have proposed that EPCOR recover the amount from rate classes 1 to 5 by way of a deferral account. OEB staff supports the proposed establishment of the "2019 Rebalancing Deferral Account". The wording of the account is attached to the settlement proposal. EPCOR will not record interest on any balance in this account. OEB staff has reviewed the description of the account and is satisfied with the wording. The revised bill impacts as a result of all the changes proposed in the settlement are discussed further in the submission.

Fully Fixed Monthly Distribution Charge for Rate 6 (IGPC)

In its application, EPCOR proposed a 100% fixed monthly charge for Rate 6 to recover the cost of distribution service effective October 1, 2018. Actual charges billed to EPCOR by Union Gas for gas supplied to EPCOR's system for IGPC shall be passed through to IGPC without any mark-up. The fixed monthly charge is $124,323.96 for the period October 1, 2018 to December 31, 2018 and $93,490 per month for the period January 1, 2019 to December 31, 2019.[23]

IGPC is expanding the ethanol facility and the volume of natural gas is projected to increase by approximately 29% beginning in November 2018. The capacity of the existing high pressure steel pipeline that serves only IGPC is adequate to handle the additional volumes. EPCOR's operating and maintenance costs to distribute the additional volumes in 2019 is expected to remain unchanged from 2018 costs. In other words, the cost to operate and maintain the existing pipeline and the newly built regulator and metering station in the 2019 rate year is expected to be the same as in the 2018 rate year.

[21] NRG requested a revenue requirement of $7,768,217 for 2016 rates, an increase of $968,725 over 2011 OEB approved, EB-2016-0236.
[22] Response to VECC IR#5
[23] Settlement Proposal, pg. 19

Under the current fixed and variable cost structure for Rate 6, the proposed increase in volumes would increase EPCOR's revenue from IGPC by approximately $621,000 for the 2019 rate year with no corresponding increase in costs apart from normal inflation adjustments. Accordingly, EPCOR has proposed a fixed monthly charge for IGPC that will not recover the additional $621,000. OEB staff has no concerns with the proposed approach and is satisfied with how the charge has been calculated.

Disposition of Deferral and Variance Accounts

OEB staff agrees with the balances in the Purchased Gas Transportation Variance Account (PGTVA), Regulatory Expense Deferral Account (REDA) and the IFRS Conversion Cost Deferral Account (IFRSDA). The PGTVA has a large credit balance of $428,919 for rate classes 1 to 5 and a credit balance of $544,304 for Rate 6 as of September 30, 2017. The balance in the REDA/IFRSDA as of September 30, 2017 is a debit of $158,260.

The parties agreed to dispose of the balances through rate riders commencing January 1, 2019. OEB staff has no concerns with the proposed disposition of these accounts.

Change in the Fiscal Year

In its application EPCOR had proposed to change the start of the rate year from October 1 to January 1 effective January 1, 2020. Since the proposed rate adjustment in this application is likely to be implemented starting January 1, 2019, parties in the settlement proposal have agreed to change the rate year effective January 1, 2019.

OEB staff supports the move to a January to December rate year as this move aligns EPCOR with other gas utilities.

Revised Bill Impacts

On November 29, 2018, EPCOR provided the revised bill impacts resulting from the changes agreed to in the settlement proposal. EPCOR has six rate classes. Rate 1 includes residential, commercial and industrial customers while Rates 2 and 4 are comprised of seasonal customers. Rate 3 includes large volume contracts customers, Rate 5 includes interruptible contract customers and Rate 6 is specifically for IGPC.

The annual rate impact for a typical residential customer consuming approximately 2,000 cubic meters a year is $34.06 (7.6%) as a result of the settlement proposal. This is almost double from the original application rate impact of $17.33. The settlement proposal does not provide details or reasons for the doubling of the rate impact as compared to the original application. OEB staff understands that the increase in the fixed monthly charge would have a larger impact on low volume (typical residential) customers. In addition, the proposed rate rebalancing that transfers a benefit of $210,000 to Rate Class 6 (IGPC) also impacts residential customers. However, EPCOR will forego revenues related to rate adjustments for 2016 and 2017 and this is a reduction of $272,000 for rate classes 1 to 5 as compared to the original application.

However, commercial and Industrial customers in Rate Class 1 will receive a larger benefit as a result of the proposed settlement. The credit for an average commercial customer will increase from $31.54 in the original application to $62.14 while an average industrial customer will see the annual credit changing from $116.12 to $218.29 as a result of the settlement proposal. IGPC will experience the largest change as a result of the settlement proposal. The total credit to IGPC (bill impact) will change from the original proposed amount of $418,521 to $835,810.

OEB staff urges EPCOR to provide on presentation day, a more detailed explanation for the doubling of the rate impact for residential customers as a result of the settlement proposal.

Status of NRG Application in Abeyance

Although the EPCOR application was filed under a different number as compared to NRG's cost of service application (EB-2016-0236), it is effectively a continuation of the original NRG application. Procedural Order No.1 in the current case notes that this case replaces EB-2016-0236, and that the interim rate order issued in EB-2016-0236 has been kept in place for the current proceeding.[24] As the current case disposes of all issues that were raised in EB-2016-0236, OEB staff suggests that EPCOR file a letter with the OEB withdrawing the original NRG file so that it can be closed. OEB staff further recommends that the panel in this proceeding formally close the original NRG file EB-2016-0236 as part of the decision and also address intervenor costs of the NRG rate case along with the cost award process in this proceeding.

– All of which is respectfully submitted –

[24] Procedural Order No. 1, September 19, 2018