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

BY EMAIL

January 6, 2020

Ms. Christine E. Long
Board Secretary and Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: Corporation of the Town of Marathon (Town of Marathon)
North Shore LNG Project
OEB Staff Submission
OEB File No. EB-2018-0329

In accordance with Procedural Order No. 1, please find attached the OEB staff Submission for the above proceeding. This document has been sent to the Town of Marathon and to all other registered parties to this proceeding.

The Town of Marathon is reminded that its Reply Submission is due by January 20, 2020.

Yours truly,

Original Signed By

Ritchie Murray
Project Advisor, Supply & Infrastructure

Encl.

c. Town of Marathon and all other registered parties to this proceeding

Ontario

North Shore LNG Project

Corporation of the Town of Marathon

EB-2018-0329

OEB Staff Submission

January 6, 2020

1 INTRODUCTION AND SUMMARY

The Corporation of the Town of Marathon (Town of Marathon or Applicant), Township of Manitouwadge, Township of Schreiber, Township of Terrace Bay and the Municipality of Wawa (collectively, the Municipalities) have resolved to form a new natural gas distribution company (Utility) to distribute natural gas in their respective municipalities. On August 2, 2019, the Applicant, on its own behalf and as a representative of the Municipalities, requested leave to construct approximately 116.5 kilometres (km) of natural gas distribution pipeline and associated approvals required for the North Shore LNG Project (Project). The total cost of the Project is $43.95 million; accounting for a $3.45 million grant from the Northern Ontario Heritage Fund Corporation, the recoverable cost of the project from ratepayers will be $40.5 million.

The Project involves building a natural gas distribution system in the Municipalities to be supplied by re-gasified liquefied natural gas (LNG). LNG is created by cooling pipeline sourced natural gas down to its liquefaction temperature of approximately -160°C. The volume of the liquid produced is about 1/600 of the volume of the natural gas in its normal gaseous state. The LNG can then be pumped into a cryogenic trailer and transported by truck to another location (just like liquid nitrogen, liquid oxygen and other cryogenic liquids). The LNG can then be transferred into an onsite storage tank and re-gasified into a traditional natural gas distribution system. The term LNG Depot is used to describe the site where the LNG storage tank, re-gasification, odourization, telemetry, pressure regulation and metering equipment would be located.

Construction of the Project is planned to start in April 2020 in order to begin providing service by the 2020-2021 heating season. Construction of the Project would continue until its completion in July 2022. The Applicant is requesting approval of the second phase of its leave to construct application by the end of March 2020[1]. In its Argument in Chief, the Applicant acknowledges however, that “[t]his schedule was optimistic having regard to the amount of time it would take to process the Application, secure financing, establish the Utility and prepare and file the technical and financial capacity information required to meet the LTC condition proposed in the Application.”

[1] As the Utility has not yet been fully organized, this first phase (Phase I) of the leave to construct application does not include information with respect to the Utility, its financial capacity and its technical ability. The Municipalities have obtained conditional commitments for the resources required to finance, operate and maintain the Utility, however, the providers of the resources cannot commit these resources unconditionally until the project is approved by the OEB. The applicant requested that the OEB issue leave to construct approval by December 2019, subject to a condition that requires the Utility to file information for OEB review and approval regarding the Utility’s technical and financial capacity in a second phase (Phase II) of the application, at a later date.

In OEB staff's view, the Project is a novel way to provide natural gas service to an area that would otherwise be uneconomic to serve by means of a traditional pipeline. The Project has the potential to build economic capacity in parts of Northern Ontario, and provide the residents and businesses in the Municipalities with an energy option that may significantly reduce their energy costs.

The application as proposed, however, is subject to a number of unmitigated risks that appear to fall disproportionately on potential natural gas ratepayers. OEB staff is not opposed to the OEB's approval of Phase I of the application, subject to the implementation of OEB staff's proposed mitigation measures as discussed below, and the requirement for the Applicant to file information for OEB review and approval regarding the Utility's technical and financial capability in Phase II of the application. OEB staff also proposes that LTC should be conditional on an approved rates application, and that the Applicant be required to file its rates application at the same time as its information on technical and financial capability. The OEB could hear the rates application separately or in combination with Phase II of this proceeding.

2 PROCESS

On December 4, 2018, the Applicant filed with the OEB a notice of intent to file its application by June 28, 2019. The OEB issued a letter on December 20, 2018 requesting that any other party currently developing a plan to provide service to the municipalities notify the OEB (Competition Letter). On January 16, 2019, Enbridge Gas Inc. (Enbridge Gas) filed a letter registering its interest to serve the Municipalities. On February 4, 2019, Enbridge Gas withdrew its interest. The Applicant filed its initial application on August 2, 2019. The Applicant filed an updated application on August 15, 2019.

The OEB issued a Notice of Hearing on September 12, 2019. Procedural Order No. 1, issued on October 1, 2019, granted intervenor status to Jackfish Metis Association (JMA) and Red Rock Indian Band (RRIB). On October 30, 2019, Procedural Order No. 2 granted intervenor status to Anwaatin Inc. (Anwaatin), Bingwi Neyaashi Anishinaabek First Nation (BNA First Nation), Certarus Ltd. (Certarus), the School Energy Coalition (SEC), and the Vulnerable Energy Consumers Coalition (VECC). The same Procedural Order also provided for interrogatories and submissions on the application. OEB staff, Anwaatin, Certarus, SEC and VECC filed written interrogatories by November 12, 2019. The Town of Marathon filed interrogatory responses on November 26, 2019, and its argument-in-chief on December 10, 2019. The Town of Marathon's reply submission is due on January 20, 2020.

3 BACKGROUND

The Municipalities have resolved to incorporate, finance and resource a yet-to-be created natural gas distribution utility (Utility) that will serve the Municipalities. The Marathon Economic Development Corporation (MEDC) is a wholly-owned subsidiary of the Town of Marathon, and is the legal entity that is developing the project, as an agent on behalf of each of the five Municipalities[2]. For the purposes of this application, the Town of Marathon, as the Applicant, is acting as an agent of MEDC[3].

3.1 Project Description

The scope of the application includes the construction and operation of the local gas distribution pipelines and ancillary facilities in each municipality, including the distribution mains, service lines and meter sets. The upstream elements, including the construction and operation of the LNG liquefaction plant, the trucking of LNG and the construction of LNG depots, are outside the scope of the application. These upstream elements would be performed by Nipigon LNG Limited Partnership (Nipigon LNG). The natural gas supply arrangements between the Utility and Nipigon LNG would be governed by a long-term LNG supply contract.

3.2 Requested Relief

The Applicant has requested the following relief, subject to it later proving its financial and technical “fitness to serve” in Phase II of the application:

1. Under the Ontario Energy Board Act, 1998 (OEB Act), section 90, **leave to construct** approximately 116.5 km of pipeline to serve the Town of Marathon, Township of Manitouwadge, Township of Schreiber, Township of Terrace Bay and Municipality of Wawa
2. Under the OEB Act section 97, **approval of the form of land use agreements**
3. Under the Municipal Franchises Act, 1990 (Franchises Act) section 8, a **certificate of public convenience and necessity** (certificate) for each of the Municipalities
4. Under the Franchises Act section 9, a **Municipal Franchise Agreement** (MFA) for each of the Municipalities
5. An order or orders approving a **Natural Gas Supply Plan** (GSP) to serve the five municipalities

[2] Applicant’s response to OEB staff interrogatory 25 c)
[3] Ibid.

6. Under the OEB Act section 36, the **Pre-approval of the cost consequences of a long-term contract** for LNG service with Nipigon LNG

A rate application would be filed after receiving leave to construct (LTC) approval from the OEB on Phase II of the application.

4 SUBMISSIONS

4.1 Summary of Staff Submissions

This Project has the potential to increase energy options and reduce energy costs for local consumers, and to improve the local economies in the Municipalities. OEB staff is concerned, however that the project is subject to a number of unmitigated risks that appear to fall disproportionately on potential natural gas ratepayers. OEB staff supports approval of Phase I of the application with a number of recommended conditions in place. This will help ensure that ratepayers are protected, while still allowing the benefits of the Project to be realized. The recommended conditions relate to increasing certainty around the connection of the industrial customer, stabilizing rates for customers, diversifying natural gas supply options and better balancing contract risk with Nipigon LNG. OEB staff also recommends modifying the form of land use agreements and the maps associated with the Certificates of Public Convenience and Necessity, filing the final Environmental Protection Plan and letter of sufficiency from the Ministry of Energy, Northern Development and Mines (MENDM) with the OEB, and requiring approval of rates in advance of beginning construction. As requested by the Applicant, approval of Phase I should be contingent on a requirement for the Applicant to file information for OEB review and approval regarding the Utility’s technical and financial capability in Phase II of the application.

4.2 Leave to Construct

Section 90(1) of the OEB Act requires that no person shall construct a hydrocarbon pipeline (pipeline) that meets certain legislated criteria of cost, length, diameter and pressure without first obtaining from the OEB an order granting leave to construct.

When reviewing an LTC application, the OEB will consider whether the project serves the public interest in terms of such things as:

1. Is there a need for the proposed project?
2. Was the proposed project selected for good reasons from among the alternatives?

3. Are the costs and economic impacts of the construction and operation of the proposed pipeline reasonable?
4. What are the environmental impacts associated with construction of the proposed pipeline and are they acceptable?
5. Are there any outstanding landowner matters for the proposed pipeline routing and construction?
6. Is the proposed pipeline designed in accordance with the current technical and safety requirements?
7. Have any issues related to the duty to consult with Indigenous peoples been satisfactorily addressed?

4.2.1 Project Need

OEB staff submits that the need for the project has been demonstrated.

The Municipalities are located along the North Shore of Lake Superior, between Nipigon and Sault Ste. Marie. The combined population of the Municipalities is approximately 11,000. At present, there is no natural gas distribution within the Municipalities and so propane, fuel oil, wood and electricity are instead relied on for energy needs. The Applicant submits that access to natural gas may benefit all sectors in the form of lower energy costs, and that the “knock on” effects may be revitalized local economies, a contribution to Ontario’s gross domestic product and a reduction in greenhouse gases[4].

The Municipalities retained Elenchus Research Associates (Elenchus) to develop 25-year natural gas market demand forecasts for the Municipalities, by customer type. Elenchus worked with Innovative Research Group Inc. (Innovative), a national public opinion research firm, to design and execute a telephone survey in the five Municipalities in order to determine the level of interest in converting to natural gas and, thus, the market demand for natural gas line connections. Based on its market assessment, the Applicant forecasts the total ten-year customer attachments to be 3,460 out of a total of 5,540 potential customers, or 62.5%. Of the 3,460 forecast attachments, 3,111 or 89.9% are residential.

To the extent that the Applicant’s projections are accurate, OEB staff agrees that the energy cost savings associated with the Project will lower the financial strain on winter heating bills for residential, commercial and institutional customers. In addition, the installation of new or updated heating systems should improve energy efficiency,

[4] Applicant’s Argument in Chief, page 12

thereby further increasing the benefit to customers and the Municipalities. The Project also has the potential to build economic capacity in Northern Ontario and promote, attract and support growth in the existing and emerging priority economic sectors identified in the Growth Plan for Northern Ontario[5]. The application includes letters of support from the Thunder Bay Chamber of Commerce, Thunder Bay Community Economic Development Corporation, RRIB, Biigtigong Nishnaabeg First Nation, and BNA First Nation.

4.2.2 Proposed Facilities and Alternatives

OEB staff has no issues or concerns with the proposed distribution pipelines within the Municipalities. OEB staff also has no issues or concerns with the Applicant's assessment of alternative routings and its rationale for selecting the preferred routing.

The proposed distribution systems within each community will consist of 15 to 35 km of nominal pipe size (NPS) 2 to 6 inch medium density polyethylene pipelines. The total combined length of all distribution pipelines will be about 116.5 km (not including individual service lines).

Alternative routings for the distribution pipelines within each municipality were considered. The preferred routes were selected based on maximizing consumer connections while minimizing environmental and socio-economic impacts.

The application states that the pipeline design specifications for the proposed Project are in accordance with the *Technical Standards and Safety Act, 2000*, and its regulations, including Ontario Regulation 210/01 - Oil and Gas Pipeline Systems and applicable Canadian Standards Association (CSA) standards, including CSA Z662/15 - Oil and Gas Pipeline Systems.

4.2.3 Project Economics

OEB staff has examined the Project's economics and is of the view that the Applicant has not sufficiently de-risked the Project to ensure its success and to reduce potential impacts on ratepayers. OEB staff is concerned that:

a) The Project economics rely heavily on a single industrial customer

b) The Applicant may not have sufficiently accounted for a number of risks in preparing the customer additions forecast and is not proposing to bear the risk

[5] https://www.ontario.ca/document/growth-plan-northern-ontario

related to customer attachment forecasts and capital cost overruns by committing to a rate stability period

Ordinarily the focus of the OEB's economic analysis in a leave to construct is on ensuring that customers of a new expansion project are not being subsidized by the utility's legacy customers. To this end, the OEB requires that project proponents conduct a net present value (NPV) assessment. In order to be approved, the NPV calculation must produce a profitability index (PI) of at least 1.0[6]. A PI value of 1.0 or higher essentially shows that the forecast revenues from the project will be at least equal to the forecast costs of the project, and thereby ensures that legacy customers are not subsidizing "new" customers. To the extent that a project's PI falls below 1.0, the utility can propose either a capital contribution or a system expansion surcharge (SES) to bring the PI up to 1.0.

Given that in this case there are no existing customers, the Applicant instead seeks to justify the economics of the Project based on estimates of the total fuel savings for residential customers over the first 40 years, which it estimates at $165.6 million in 2020 dollars (net of conversion costs). The Applicant estimates that the total fuel savings for commercial and industrial customers over the first 40 years is $100.6 million in 2020 dollars (not net of conversion costs). The Applicant explains that the commercial and industrial savings are not net of conversion costs because conversion costs for these customers would vary greatly based on the current fuel use and building specifications of each customer. However, the applicant expects that energy cost savings would materially outweigh conversion costs[7].

To the extent that the Applicant's projections are accurate, OEB staff agrees that the Project will benefit the Municipalities by increasing energy options for local consumers and helping to reduce their energy costs, and that the project has the potential to improve the local economies of the Municipalities. However, as noted above, OEB staff is concerned that the success of the Project and its economic benefits are heavily reliant on a single industrial customer.

Heavy Reliance of Project Economics on Single Industrial Customer

There is one large industrial customer in the region that currently uses No. 6 residual fuel oil as its energy source and is interested in using natural gas. The pulp mill in Terrace Bay (Mill) has agreed in principle to a demand response program, under which the Mill would be served on an interruptible basis. Under this arrangement, the Mill

[6] The OEB's requirements for the economic evaluation of distribution systems is set out in E.B.O. 188.
[7] Exhibit A, Tab 9, Schedule 2, page 3

would increase its use of natural gas when gas supply resources were not required by firm customers of the Utility. Similarly, as firm customers require increased natural gas supply, the Mill would reduce its use of natural gas. Therefore, the demand response program would effectively give the Project as a whole a 100% load factor. This arrangement effectively mitigates both a) underutilized upstream transportation of the Nipigon LNG facility and b) LNG fixed costs, which, according to the Applicant, would both be "much higher" without the Mill as a demand response customer. However, this approach may necessitate mitigating measures were the Mill to significantly reduce or stop consuming natural gas. OEB staff notes that this would include selling surplus natural gas into the secondary market – possibly at a financial loss.

The Applicant estimates that the total forecasted annual consumption for all customers by year 11 will be 1,255,135 GJ. Of that, the Corporation estimates that the total annual consumption of the Mill will be 816,000 GJ, or approximately 67% of the total demand for all customers[8]. Regardless of whether it is consuming No. 6 residual fuel oil or natural gas, the Mill's energy profile is relatively constant year-round.

Having the Mill as a customer is clearly a very important component of the Project. However, OEB staff is concerned that there is a risk of significant rate increases if the Mill, for whatever reason, significantly reduces its consumption of natural gas or stops consuming natural gas.

OEB staff notes that the Mill has gone out of business at least twice in the last ten years[9]. OEB staff also notes that, although plans to develop a regional natural gas delivery system were well known and in the public realm as early as 2015[10], the Mill has yet to sign a contract for a demand response program[11].

If the Mill were to stop taking gas for whatever reason during the initial ten year term of the Project, then the average annual residential bill would increase by about $2,093[12] from about $1,693[13] to about $3,786. This would more than eliminate all of the fuel savings associated with converting to natural gas, which is estimated to be about

[8] Exhibit A, Tab 8, Schedule 1, Attachment 1, Table 3, page 25
[9] https://www.cbc.ca/news/canada/thunder-bay/revitalize-adapt-terrace-bay-1.4734361
[10] Applicant's foreword to its responses to Certaurus' interrogatories.
[11] Applicant's response to OEB staff interrogatory 13 a)
[12] The applicant's response to OEB staff interrogatory 13 i) indicates that the impact on landed LNG cost due to the Mill ceasing business would be an increase of approximately $24.67 GJ/year. The application forecasts an annual residential consumption of 84.85 GJ / year (A-4-1, p. 17). OEB staff calculates the annual bill increase to be $24.67 GJ/year x 84.85 GJ / year = $2093.25 / year. This does not include a relatively minor increase in distribution charges of between $2.16 to 3.72 per year per customer bill if the Mill were to permanently cease operations.
[13] Exhibit A, Tab 4, Schedule 2, page 2

$1,500 per year[14] in many cases. If this were to happen, it is possible that many residential and other customers would also cease to be customers of the Utility, which would further increase the rates for the customers that remained. OEB staff submits that it appears that the Project is not viable without the Mill.

OEB staff asked the Applicant if a letter of credit would be appropriate to manage the risk associated with the industrial customer going out of business. The Applicant responded that it would be, but that it did not view doing so as “commercially feasible”[15]. OEB staff notes that the use of a letter of credit has been used by other gas utilities in Ontario to mitigate risk associated with industrial customers[16]. It is also notable that the Utility itself will be providing a letter of credit to Nipigon LNG as one of the terms of its long term gas supply contract (discussed in more detail below).

OEB staff submits that the LTC application should not receive final approval until the Applicant or Utility has filed a letter of credit or similar financial security from the Mill. OEB staff further submits that the letter of credit should be filed within six months of the OEB’s decision on Phase I of this application or as part of Phase II of the application, whichever is earlier.

Forecast Attachments and the Rate Stability Period

Fuel savings are determined by multiplying forecast customer additions by the anticipated savings from fuel switching[17]. OEB staff observes that the methodology used by the Applicant to assess market potential and the resulting attachment forecast is consistent with recent community expansion projects[18] as summarized in the following table.

Table 1: Market Assessment Comparison of Recent Community Expansion Projects

Docket	Applicant	Project Name	Residential Attachment Rate	Commercial / Institutional Attachment Rate	Indistrial Attachment Rate
EB-2018-0329	**Marathon**	**North Shore**	**62%**	**65% - 84%**	**100%**
EB-2017-0147	Enbridge	Fenelon Falls	84%	77%	100%
EB-2017-0261	Enbridge	Scugog Island	76%	80%	N/Applicable
EB-2018-0263	EPCOR	South Bruce	60%	65%	N/Available
Average of Comparator Projects			**73%**	**74%**	**100%**

[14] Exhibit A, Tab 4, Schedule 3, page 1
[15] Applicant’s response to OEB staff interrogatory No. 34 b)
[16] E.g., EB-2009-0187, Enbridge Gas Distribution Inc., York Energy Centre Project
[17] Exhibit A, Tab 4, Schedule 3, pages 1 - 3, Tables 1 and 2
[18] EB-2017-0147, Exhibit B, Tab 1, Schedule 1, page 20; EB-2017-0261, Exhibit C, Tab 1, Schedule 1, page 8; EB-2018-0263, Exhibit A, Tab 3, Schedule 1, page 3

However, OEB staff is concerned that a number of risks may not have been sufficiently accounted for in preparing the customer additions forecast:

- The Municipalities are facing declining populations, which has not been accounted for in the customer attachment forecasts
- The Municipalities have aging populations and a large number of residents in the Municipalities are on fixed incomes[19]
- Cost is a primary reason for not converting[20], and the Applicant has no firm plans for a conversion financing assistance program
- About 360 of the approximately 2,670 people (or about 13.5%) who live in Terrace Bay and Schreiber rely on the industrial customer for employment
- The Applicant states that the project remains economically viable at up to 50% lower attachment rates[21], however, this is only true as long as the industrial customer continues to take gas

The applicant is not proposing to bear the risk related to customer attachment forecasts and capital cost overruns by committing to a rate stability period. Therefore, the risk of lower than forecast attachments and capital cost overruns is placed on ratepayers.

The decision from the Generic Proceeding on Community Expansion established a framework for competition to serve new communities that cannot achieve economic feasibility in a manner consistent with E.B.O. 188. The framework allows for stand-alone rates or surcharges to prevent cross-subsidization[22], competition to provide an incentive for utilities to lower costs, and the establishment of a rate stability period so that utilities bear the risk around customer attachment forecasts and capital cost overruns.

Given that the Utility would be a new entrant, there is no issue with its rates needing to be stand-alone. Furthermore, although the OEB issued the Competition Letter in December, 2018, there was no competitive process in this case. OEB staff submits, however, that a rate stability period is required for the Project.

During a rate stability period, customers can expect rate stability since the proponent's revenues relative to its controllable costs will be capped at a proposed level. In its decision in the Generic Proceeding on Community Expansion[23], the OEB said:

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[19] Exhibit A, Tab 4, Schedule 3, page 5
[20] Exhibit A, Tab 4, Schedule 1, page 10
[21] Applicant's response to SEC interrogatory 10
[22] Proponents were expected to base their revenue requirement proposal on fully allocated project and OM&A costs.
[23] OEB's Decision and Order in the Generic Proceeding on Community Expansion, EB-2016-00004 (17

> [T]he rate stability feature of the framework introduces a discipline that significantly reduces the need to scrutinize a proponent's projected revenues. As the rates will be stand-alone and designed to cover the costs of the proposed expansion the existing customers will be held harmless. Overstated costs would lead to overstated rates and where there is competition for the approval, a proponent will risk not being chosen. Where there is no competition, a proponent will still be incented to have as low a rate as it can afford to encourage customers to connect and provide the return on the proponent's investment during the rate stability period. The proponent will also have to obtain approval to adjust rates beyond the rate stability period.

Absent a rate stability period, lower than forecast customer attachments will result in the fixed costs (which are largely set) being spread among a smaller customer base, and therefore higher rates and reduced savings. These higher rates will act to discourage new attachments.

In its Argument-in-Chief, the Applicant noted that, in this case, there is no competing utility and, so, there is no incentive to overstate or understate forecasts in order to be selected as a successful proponent. The Applicant's position appears to be that, in this case, a rate stability period is therefore not required. However, OEB staff notes that in other recent community expansion projects[24], the proponents have adopted a rate stability period to help mitigate impacts on ratepayers from lower than forecast customer attachments or capital cost overruns, even though to date, there has only been one community expansion project where there was competition[25].

OEB staff appreciates that a stability period is to some extent a rates issue, and that this is not a full rates proceeding. However, OEB staff believes that it is important for the OEB, the Utility, and its potential customers to understand at least at a general level what type of rate treatment can be expected once the Project comes into service. In order for customers to switch to natural gas they will be required to undertake expensive conversion work (estimated to cost between $750 and $12,500). If there is a risk that their rates could rise materially in the early years of service it would be important for them to know that.

November2016), pages 20-21

[24] EB-2016-0137 / EB-2016-0138 / EB-2016-0139, EPCOR Southern Bruce Gas Inc., South Bruce expansion projects; EB-2017-0147, Enbridge Gas Inc., Fenelon Falls; EB-2019-0139, Enbridge Gas Inc., Chippewas of the Thames

[25] EB-2016-0139, EPCOR Southern Bruce Gas Inc., South Bruce expansion projects

OEB staff submits that the Utility should be required to provide a 10-year rate stability period during which it assumes risks associated with the customer forecast and capital overruns. This would be consistent with the Generic Decision and several subsequent community expansion projects.

The Applicant stated that if the OEB were to impose a rate stability period, it would track revenue shortfalls in a deferral account for possible disposition after the end of the minimum rate stability period[26]. In OEB staff's view, this approach is not in the spirit of a rate stability period.

OEB staff submits that, given the operating history of the Mill and the potential harm to other ratepayers if the Mill significantly reduces its usage or stops using natural gas, as well as the risks which may not have been sufficiently accounted for in preparing the customer additions forecast, the OEB's approval should be conditional on all of the following:

a) The Applicant securing a suitable letter of credit or similar financial security with the industrial customer, in addition to the contract that the Utility and the industrial customer intend on entering into

b) A minimum 10 year rate stability period

As noted above, the Applicant has stated that it believes a letter of credit is not "commercially feasible". However, absent a letter of credit, or some other financial assurance, it is unclear to OEB staff how the Utility intends to protect its own interests and those of its ratepayers in the event that the Mill stops taking gas partway through the ten year customer connection horizon (or a ten year rate stability period, if the OEB were to mandate one). Without the Mill as a customer, OEB staff questions whether the entire project is feasible.

In OEB staff's view, if a letter of credit or other financial assurance is not possible the Applicant should file as part of its reply submission a mitigation plan for the event that the Mill stops taking gas in year five – after the majority of customers have converted to natural gas. The Applicant should explain how its mitigation plan could be different depending on whether or not the OEB mandates a rate stability period. The mitigation plan should explain how the Utility plans to continue operations and protect its other ratepayers if the Mill ceases to be a customer.

OEB staff understands that to date there is no formal agreement between the Applicant and the Mill confirming that the Mill will actually be a customer of the Utility. OEB staff

[26] Applicant's response to OEB staff interrogatory No. 12 c)

submits that another alternative to a letter of credit is for the Applicant to file with the OEB as part of Phase 2 a copy of the negotiated agreement between the Utility and the Mill, if possible prior to the agreement being executed. This will allow the OEB to examine the protections the agreement offers to each the Mill and the Utility (and by extension its ratepayers).

OEB staff considered the following alternatives to a rate stability period, but believes they do not provide adequate protection for ratepayers in the event that the Mill significantly reduces its usage or stops using natural gas:

a) A minimum percentage of pre-signed service agreements with residential, commercial and institutional customers to help ensure construction does not begin until a sufficient number of customers have signed up

b) The applicant setting up a reserve (from retained earnings) to mitigate the impact on residential, commercial and institutional customers were the industrial customer to significantly curtail its load or go out of business

Estimated Capital Costs of Project are Reasonable

OEB staff is satisfied that the estimated capital costs of the Project are comparable to other recent expansion projects and are therefore reasonable.

The total capital cost of the Project is estimated to be $43.95 million[27]. The budgeted contingency of $10.502 million represents approximately 24% of the total capital cost.

OEB staff prepared the following table that summarizes the costs of recent and comparable projects with the proposed Project.

Table 2: Cost Comparison of Recent Community Expansion Projects

Docket	Applicant	Project Name	Capital Cost ($ millions)	Contingency	Length (km)	Diameter (inches)	$ / m	Comparison of $ / m
EB-2018-0329	**Marathon**	**North Shore**	**$ 43.95**	**24%**	**117**	**4, 6**	**$ 377**	**--**
EB-2017-0147	Enbridge	Fenelon Falls	$ 23.10	10%	37	4, 6, 8	$ 623	65%
EB-2017-0261	Enbridge	Scugog Island	$ 3.45	10%	7	4	$ 493	31%
EB-2018-0226	Enbridge	Georgian Sands	$ 5.77	20%	14	6, 8	$ 401	6%
EB-2018-0263	EPCOR	South Bruce	$ 87.10	5%	245	2, 4, 6, 8	$ 356	-6%
		Average of Comparator Projects		**11%**	**76**		**$ 468**	**24%**

OEB staff notes that the unit costs of the Project are generally lower than comparable community expansion projects, but that the contingency is significantly higher.

27 Gross of a grant of $3.45 million from the Northern Ontario Heritage Fund Corporation through its strategic Economic Infrastructure Program.

In response to an interrogatory, the Applicant explained that a consultant had developed the capital cost estimate including the level of contingency. With respect to the contingency, the Applicant believes that it is a reasonable indication of the degree of capital cost uncertainty regarding the Project at the time of filing. The Applicant says that, following OEB approval, the Municipalities will advance the Project and refine the capital cost estimate (and reduce the contingency), through the following work:

- Detailed design of the gas distribution system in each Municipality
- Field survey in each Municipality
- Geotechnical investigation in each Municipality, including exploring the amount of rock trenching required for the gas distribution system
- Competitive construction cost bids from contractor

OEB staff submits that the Applicant is acting prudently with respect to capital costing and contingency. Further, OEB staff notes that if the project is approved, cost overruns on the Utility's capital costs will be subject to a prudence review in its inaugural rate application or the application in which it seeks to include the costs in rate base. OEB staff submits that, among other things, the Utility should be required to report on and explain any cost over runs and its contingency usage at that time.

4.2.4 Environmental Issues

OEB staff has no environmental or archeological concerns with the proposed Project. However, OEB staff submits that OEB approval should be conditional on the filing of the final version of the Environmental Protection Plan (EPP).

The Applicant retained Stantec Consulting Ltd. (Stantec) to undertake a route and liquefied natural gas storage depot evaluation and environmental and socio-economic impact study for each Municipality. Mitigation measures designed to minimize environmental and socio-economic impacts were also developed as part of each study. The study results have been documented in the five Environmental Reports (ERs). The ERs conform with the OEB's *Environmental Guidelines for the Location, Construction and Operation of Hydrocarbon Pipelines and Facilities in Ontario* (7th edition, 2016). In Stantec's opinion, the implementation of the recommended mitigation and protective measures outlined within the ERs will adequately protect the sensitive environmental features throughout the construction process.

The Applicant submitted the ERs to the Ontario Pipeline Coordinating Committee (OPCC) on August 2, 2019. OEB staff notes that the EPP, which is intended to compile all the recommendations for mitigation and monitoring, including that of the OPCC, was not filed as part of the application. The Applicant stated that the Utility will develop an EPP and that it will be completed prior to tendering the package to construction contractors, and circulated to the OPCC once developed. OEB staff submits that OEB approval should be conditional on filing the final version of the EPP. To the extent any concerns are identified by OPCC members or parties related to the EPP, the EPP may have to be reviewed further by the OEB as part of Phase II of the application.

4.2.5 Indigenous Consultation

OEB staff notes that the Utility has not yet filed the sufficiency letter from the MENDM. A number of Indigenous groups have intervened in this proceeding, however to date no specific concerns regarding the proposed Project have been stated on the record. Some general concerns have been raised about the safety of transporting the LNG by truck, but in OEB staff's view that is both outside the scope of the current applications (which do not seek any specific approvals for the transportation of the gas by truck), and under the jurisdiction of other authorities.

OEB staff submits that if the OEB grants the Applicant leave to construct, such approval should be conditional on receiving the letter of sufficiency from MENDM. If available, the Applicant could provide the letter with its reply submission (in which case, this would not need to be added as a condition of approval). To the extent any concerns are identified by Indigenous communities that relate to the applications that are before the OEB, the matter may have to be reviewed further by the OEB either as part of this phase of the proceeding, or in the second phase of this proceeding, depending on the timing of the new information.

On March 18, 2019, the Applicant contacted the MENDM with respect to the Crown's duty to consult and received correspondence on May 21, 2019, indicating that the procedural aspects of the duty to consult are delegated to the Applicant. The letter from MENDM identified 13 First Nation and Métis communities to be consulted as they may have Aboriginal or treaty rights that may be impacted by the Project.

The Applicant stated that letters were sent to the Indigenous communities requesting information on impacts that the Project may have on constitutionally protected Aboriginal or treaty rights and measures for mitigating those impacts[28]. In its environmental reports, the Applicant also stated that no refinements to the Project or

[28] Applicant's response to Anwaatin's interrogatory 8 a)

recommended mitigation or protective measures were necessary as a result of Indigenous input[29].

The Applicant has continued to engage with Indigenous communities through written and verbal communications, face to face meetings, presentations and community meetings[30], and continues to work with the MENDM regarding the sufficiency of its Indigenous consultation activities[31]. As of November 21, 2019, three First Nations were still listed as "pending" under the Ministry review due to a lack of response from the respective First Nations to the Ministry[32].

The Applicant also included in evidence letters of support for the Project from three of the First Nation communities identified in MENDM's letter dated May 21, 2019: Red Rock Indian Band (Nipigon, ON), Biigtigong Nishnaabeg (Heron Bay, ON) and Bingwi Neyaashi Anishinaabek (Greenstone, ON)[33].

OEB staff is not aware of any duty to consult related concerns regarding the Project itself. OEB staff recommends, however, that any approval be conditional on the Applicant receiving the sufficiency letter from MENDM.

4.2.6 Land Matters

Section 97 requires that information on land requirements must be included as part of the LTC application. LTC shall not be granted until the applicant satisfies the OEB that it has offered or will offer to each owner of land affected by the approved route or location an agreement in a form approved by the OEB. An affected landowner means those owners of land upon, over or under which it is intended to construct a hydrocarbon pipeline. An applicant may file its forms of land use agreements for approval even if it is not certain they will be needed.

The proposed distribution pipelines will be located within road allowances. However, the Applicant says that temporary working areas may be required along the route where the road allowance is too narrow or confined to facilitate construction, and agreements for temporary working rights will be negotiated where required.

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[29] Exhibit A, Tab 10, Schedule 1, Attachment 1a, Section 3.5.6.2
[30] Applicant's response to OEB staff interrogatory 21
[31] Applicant's response to OEB staff interrogatory 20
[32] Ibid.
[33] Application, Exhibit A/Tab 4/Schedule 5/Attachment 1, pp. 1-5

The Applicant filed its form of Working Area Agreement[34]. OEB staff compared the form of agreement to similar agreements filed by other gas distribution utilities in Ontario. OEB staff submits that the Applicant's form of Working Area Agreement is not acceptable as-is, and should only be approved by the OEB if the Applicant addresses the following omissions:

a) An offer by the Applicant to cover the cost of independent legal advice for the landowner

b) Written confirmation that the Applicant and its constructor have appropriate insurance coverage

c) Written contemplation of agreement termination

d) Written description of the Applicant's alternative dispute resolution process

e) Notice that equipment, spoils, parts & materials may be stored on the property

f) Environmental protection obligations on the part of the Applicant

The Municipalities have resolved to acquire (if necessary) the land required for the LNG Depots and then sell or lease this land to the Utility. The Utility will, in turn, sell or lease the land to Nipigon LNG for it to construct the LNG Depots upon[35]. At the time the application was filed, all such land was owned by the Municipalities except for the Township of Terrace Bay, which was in negotiations with a private landowner (the industrial customer) regarding the purchase / lease of a piece of property for the purposes of constructing the Township's LNG depot. In response to an interrogatory, the Applicant indicated that a letter of intent has been signed between Terrace Bay and the private landowner for the purchase of the proposed piece of property[36]. OEB staff notes that, although they are needed for gas supply to the Municipalities, the LNG Depots are outside the scope of this application. Nonetheless, OEB staff believes it is worth noting that it is satisfied that that all land required for LNG depots will be available for use when required.

In response to an interrogatory, the Applicant volunteered to make a post-construction filing with the OEB that provides evidence of landowner satisfaction with post-construction clean-up when complete[37]. OEB staff submits that this information could be

[34] Tab 11, Schedule 1, Attachment 5; the applicant also filed its form of Land Sale Agreement and its form of Land Lease Agreement. In OEB staff's view, section 97 of the OEB Act does not require that these forms of agreement be filed. As a result, OEB staff makes no submission on them.
[35] Applicant's Argument-in-Chief, page 27
[36] Applicant's response to OEB staff interrogatory 23 a)
[37] Ibid.

made available as part of the post-construction report that is required as a standard condition of LTC approval.

4.2.7 Other Matters

Rates Application

OEB staff submits that the LTC should be conditional on approved rates. This would prevent the Utility from beginning construction of the pipelines before it can determine whether its approved rates will be attractive to potential customers, its customer attachment forecast is achievable, and the overall Project is feasible. OEB staff submits that the Applicant should be required to file its rate application at the same time that it files its technical and financial information for Phase II of the application under separate cover.

Transfer of LTC and Other OEB Approvals

After the Utility is formed, the LTC will be transferred to the Utility through an application filed jointly by the Applicant and the Utility under section 18 of the OEB Act. As discussed below, the certificates and MFAs will also be transferred to the Utility.

OEB staff submits that the Applicant should be required to notify the OEB in writing once the Utility has been created.

Other Permits and Approvals

OEB staff notes that LNG safety is an area of interest for some intervenors. Although the trucking of LNG and the LNG Depots are critical to the success of the Project, as noted in section 5.2.5 of this submission, OEB staff submits that these are issues for the Ontario Technical Standards and Safety Authority (TSSA) and other authorities, and are outside the scope of this proceeding. OEB staff notes that as a standard condition of approval, the Applicant is required to obtain all necessary permits, authorizations and approvals.

4.2.8 Conditions of Approval

The OEB Act permits the OEB, when making an order, to “impose such conditions as it considers proper.”[38]

[38] OEB Act, s. 23

As part of an interrogatory, OEB staff asked the Applicant to comment on a set of proposed conditions of approval. With the exception of the first two, these conditions are standard for most leave to construct applications. In response to the interrogatory, the Applicant requested one change to the set of conditions proposed by OEB staff. The Applicant asked that condition No. 4 be adjusted such that it allows for 24 months between LTC approval and the beginning of construction as opposed to the standard 12 months. OEB staff has no issues with this requested change. The revised set of proposed conditions of approval are attached as Appendix A.

An additional set of conditions of approval, which have not been reviewed and commented on by the Applicant but that have been discussed throughout OEB staff's submission, are summarized in the Conclusion.

4.3 Certificates of Public Convenience and Necessity

OEB staff notes that, as part of an interrogatory response, the Applicant provided draft certificates to be issued to the Applicant as the agent of MEDC[39]. OEB staff has no issue with the OEB issuing the certificates the Applicant as the agent of MEDC. After the Utility is formed, the certificates will be transferred to the Utility, through an application filed jointly by the Applicant (as the agent of MEDC) and the Utility under section 18 of the OEB Act in Phase II of the application.

OEB staff submits that the maps filed by the Applicant in its interrogatory response do not adequately illustrate the boundaries of the certificates being requested[40]. In a recent application, the OEB indicated that all rate-regulated natural gas distributors in the province are expected to file with their franchise and certificate applications a map which accurately delineates a distributor's service boundaries, as well as the general location and density of the customers served[41]. Given that the Applicant or the Utility has yet to sign up any customers, only boundary maps are required in this case. In OEB staff's view, the boundary maps need to be scaled such that the municipality in question fills the page, have geographic features (e.g. major streets, lakes, railway lines) identified with legible font, and have a north arrow.

OEB staff also notes that for new entrants, part of the OEB's consideration of an application for a certificate is an assessment of the Utility's fitness to serve in terms of financial and technical capabilities. The Applicant states that it will file the information it

[39] Applicant's response to OEB staff interrogatory 25 b) and Argument in Chief
[40] Applicant's response to OEB staff interrogatory 25 d)
[41] EB-2017-0159, Decision and Order, July 20, 2017, Enbridge Gas Application for Approval of A Franchise Agreement with the Town of Collingwood.

believes will help the OEB make a decision on its fitness to serve soon after this first phase of the application is complete[42]. OEB staff has reviewed the Applicant's list of information to be provided and has nothing to add. OEB staff makes no submission at this time as to the Applicant's or the Utility's fitness to serve, but anticipates that the OEB will provide an opportunity for further submissions on the Applicant's financial and technical fitness to serve as part of the second phase of this application.

4.4 Municipal Franchise Agreements

OEB staff has no issue with the OEB granting the applicant's request to approve the terms and conditions of the MFAs between the Municipalities and the MEDC.

The MFA between the Town of Marathon and MEDC filed by the Applicant is in the form of the 2000 Model Franchise Agreement without any modifications, and the Applicant states that the MFAs between the other Municipalities and MEDC are identical. The Applicant also filed the by-laws passed by each of the Municipalities indicating their agreement with the terms of, and their intention to enter into the MFAs. The Applicant stated that the five MFAs will be signed and executed after OEB approval is obtained[43], and that the MFAs will be transferred to the Utility once it is formed[44].

OEB staff notes that the filed by-laws are not consistent with the process set out in E.B.O. 125, which is for a distributor to file an unsigned MFA for approval, with a resolution from the municipal council to support the request to approve the MFA, rather than a passed by-law. Section 9 of the Franchises Act states that no by-law granting the right to construct or operate works for the distribution of gas can be submitted to the municipal electors for their assent unless the terms and conditions upon which and the period for which such right is to be granted has first been approved by the OEB. The same section states that the OEB, after holding a public hearing, can declare and direct that the assent of the electors is not necessary.

However, OEB staff submits that the OEB should still approve the MFAs, and declare that the assent of the electors is not necessary. The MFAs remain unsigned to date, and will be executed after the OEB has approved the terms and conditions of the MFAs. OEB staff also submits that as per the OEB's typical practice, the OEB should dispense with the assent of the municipal electors. In the future, the Applicant, or rather the Utility, should follow the process set out in E.B.O. 125 and the Franchises Act.

[42] Application, Exhibit A, Tab 3, Schedule 1, pages 5-6
[43] Application, Exhibit A, Tab 6, Schedule 1, page 1
[44] Applicant's response to OEB staff interrogatory 25 h)

After the Utility is formed, the MFAs will be transferred to the Utility through an application filed jointly by the Applicant and the Utility under section 18 of the OEB Act.

4.5 Gas Supply Plan

The Applicant has requested approval of its GSP. OEB staff notes that the OEB does not approve GSPs, but rather will approve the cost consequences of the GSP. The Utility is expected to comply with the OEB's *Framework for the Assessment of Distributor Gas Supply Plans*, which requires that the Utility file its full GSP every five years and provide annual updates once the utility is operational.

OEB staff has reviewed the GSP and is satisfied that the plan adequately addresses the guiding principles of cost effectiveness and reliability with respect to the commodity, upstream transportation, and other transactional services upstream of the LNG liquefaction facility. However, OEB staff is concerned that:

a) The Utility intends to rely 100% on LNG supplied by Nipigon LNG

b) Compressed Natural Gas (CNG) was not sufficiently assessed as a secondary supply to LNG supply for peak shaving and emergency back-up supply

Diversification in the Gas Supply Plan and CNG as a Secondary Supply

The Applicant assessed two alternatives to gas supply from the LNG liquefaction facility to the municipal distribution systems: CNG service and a lateral pipeline. The Applicant filed a landed cost analysis, which it says demonstrates that LNG is the most beneficial and cost-effective option. Based on the results of the analysis, the Applicant ruled out new transmission pipeline facilities and trucked CNG in favour of trucked LNG as the primary means of gas supply to the Municipalities[45]. Key findings of the analysis include:

- The capital cost of a pipeline project cannot be supported by the size of the potential natural gas market within the Municipalities.
- The estimated landed costs for the CNG alternative would be operationally similar to the LNG option and has a similar cost structure.
- There is a significant difference in trucking costs between the CNG and LNG options. This is because the energy density per unit of volume of CNG is lower than that of LNG, thereby requiring more truck deliveries.
- LNG provides a higher reliability factor than CNG as it requires fewer trucks to be on the road, especially during the winter months.

[45] Exhibit A, Tab 8, Schedule 1, Attachment 1, page 27

The Applicant also assessed alternate sources of LNG supply from Enbridge Gas' LNG facility in Hagar, Ontario; Énergir's[46] facility in Montreal, Quebec; and a supplier in Minneapolis, Minnesota. The Montreal and Minneapolis sources were found to be 30-50% higher in cost. Enbridge Gas' LNG supply is only available as an interruptible service.

In OEB staff's view, the Applicant has made its case that LNG is the most beneficial and cost-effective option. However, OEB staff is concerned about a lack of diversification in the Gas Supply Plan and that CNG was not identified in the application as a secondary supply source.

In response to interrogatories, the Applicant has indicated that provision for secondary gas supplies using LNG or CNG can be constructed "just downstream of the LNG Depots"[47] and doing so may not impact the schedule or budget of the Project[48], except to the extent that additional land may be required[49].

OEB staff submits that, as a condition of approval, the Applicant should be required to install facilities to receive secondary sources of CNG downstream of the LNG Depots. Doing so would ensure immediate open access to the distribution systems by other gas suppliers (either LNG or CNG) using the virtual pipeline approach. To some extent, this would help mitigate the lack of diversification in the Gas Supply Plan, and would facilitate the use of CNG for peak shaving or emergency back-up supply should the need arise.

With respect to the cost consequences of the GSP, OEB staff notes that the Applicant will be required to file Quarterly Rate Adjustment Mechanism (QRAM) applications to the OEB for the approval of commodity, upstream pipeline transportation, and related costs.

4.6 Long-Term LNG Supply Contract

The Applicant has requested approval of the cost consequences of the long term gas supply contract (Contract) it proposes to enter into with Nipigon LNG. An un-executed draft of the Contract, the parties to which would be Nipigon LNG and the Utility, was

[46] Gaz Métro was rebranded as Énergir in November, 2017.
[47] Applicant's response to OEB staff interrogatory 45
[48] Applicant's response to OEB staff interrogatory 11 c)
[49] Ibid.

filed with the Application. The Applicant indicated that the Contract would not be executed until the OEB granted pre-approval for the cost consequences.

The Guidelines

The OEB has developed *Filing Guidelines for Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts* (Guidelines). The Guidelines allow utilities to request approval of the cost consequences of certain long-term gas supply contracts, provided that certain conditions are met. The OEB's most thorough consideration of an application pursuant to the Guidelines related to an application by Union Gas Limited and Enbridge Gas Distribution Inc. (which were at the time separate companies) for approval of the cost consequences related to a proposed 15 year contract to use the (at the time under development) Nexus pipeline to transport gas from the Appalachian region to the Dawn hub (Nexus Decision)[50].

The Guidelines establish a two-part test for obtaining pre-approval. The first part of the test determines whether the type of contract is eligible for pre-approval. If the contract is eligible, the second part of the test determines whether pre-approval should actually be granted. The Guidelines do not provide specific criteria for the second part of the test, but indicate the evidence to be filed in support of the application including the needs, costs, benefits, diversity and risks associated with the contract. The OEB's assessment of both parts of the test will determine whether pre-approval is granted.

OEB approval is not required for the Applicant to proceed with the Contract, and it may execute the Contract without pre-approval. However, absent pre-approval, the Applicant bears the risk of recovering the cost consequences of the Contract.

Part 1 of the test: Is the Contract the type of contract that is eligible for pre-approval?

OEB staff accepts that the Contract meets the first part of the test: it is the type of contract that is eligible for approval under the Guidelines.

Pre-approval of the cost consequences of a supply contract is an exception to the OEB's ordinary practice. Usually supply contract costs are considered through the normal rate setting process (often through a QRAM application). The Guidelines arose from the recognition that utilities might not be willing to enter the long-term commitments that are sometimes demanded by the developers of new pipelines or other gas

[50] EB-2015-0166 / EB-2015-0175, Decision and Order, December 17, 2015

infrastructure unless they were assured in advance that the OEB would not disallow the costs associated with such commitments. Without pre-approval, needed infrastructure might not be built. As the OEB explained in its January 27, 2011 decision in EB-2010-0300 / EB-2010-0333, a case where it had to determine an application under the Guidelines, the adoption of the pre-approval process "was recognition by the Board that as a matter of commercial reality the developers of natural gas infrastructure must in some circumstances require long-term commitments to support large infrastructure investments." To facilitate the development of such infrastructure, "it was reasonable to make provision for an extraordinary process wherein the costs consequences of such long term arrangements could be pre-approved".

The OEB issued a report[51] when it circulated the draft Guidelines, which noted:

> The Board believes that these applications should be limited to those that support the development of new natural gas infrastructure (e.g., new transportation facilities to access new natural gas supply sources). The Board does not believe that the pre-approval process for long-term contracts should be used for the utility's normal day-to-day contracting, renewals of existing contracts and other long-term contracts. These contracts should continue to be addressed in the utility's rate application.

OEB staff submits that the purpose of the Contract is to support the development of new natural gas infrastructure, in particular the Nipigon LNG facility. Although it will not provide access to new natural gas supply sources (the Nipigon LNG facility will be connected to TC Energy's existing pipeline, which sources most of its gas from the Western Canada Sedimentary Basin), it will facilitate the delivery of gas to an area that is not currently served. In the Nexus Decision the OEB confirmed that it was not necessary that the new infrastructure relate to entirely new gas supply sources[52]. Although "long term" is not defined by the Guidelines, OEB staff accepts that a ten year term qualifies.

Part 2 of the test: Should pre-approval be granted?

The second part of the test is whether pre-approval should be granted. Although the Guidelines do not provide specific criteria for the second part of the test, they indicate the evidence to be filed in support of the application including the needs, costs, benefits, diversity and risks associated with the contract. The OEB confirmed in the Nexus

[51] EB-2008-0280, Report of the Board: Draft Filing Guidelines for the Pre-Approval of Long-Term Natural Gas Supply and / or Upstream Transportation Contracts (Attachment B to the Draft Guidelines), page 4
[52] Nexus Decision, page 10

Decision that these were the key considerations in determining whether pre-approval should be granted[53].

OEB staff has concerns about some of the provisions of the Contract, and does not believe that the OEB should grant pre-approval of all of the costs of the Contract as currently drafted.

OEB staff is aware that there are limited options for bringing natural gas to the Municipalities, and that it is likely that a long-term contract would be required by any natural gas service provider to ensure that its investment is viable. OEB staff also recognizes that because of the limited supply options, the Utility (and, to some extent, by extension its ratepayers) may have to take on more risk than a utility that has multiple convenient supply options. Despite this, OEB staff is not satisfied that all of the provisions of the Contract adequately protect the utility (and by extension its ratepayers). OEB staff has three major areas of concern: uncertain costs, an unequal allocation of risk, and the duration of the initial contract term.

Uncertain costs

One of OEB staff's chief concerns is that, although the Applicant is seeking approval for the cost consequences of the Contract, not all of the costs that will be covered by the Contract are currently known. For example, section 4.1(b) of the Contract provides that the Utility will be responsible for a "Variable Charge" to cover the variable costs of providing the LNG service. However, the amount of the variable charge is not specified. In an interrogatory response the Applicant estimated that the charge would be approximately $0.34 per GJ[54]. This amount does not appear in the Contract itself. Instead, the Contract allows Nipigon LNG to set the amount of the Variable Charge. Although the Applicant states that the Nipigon LNG will set the Variable Charge without mark-up, the contract does not specify this (and in fact other sections, such as the truck transportation provisions discussed below, do specify that the charges are to be without mark-up, which suggests that there is no similar requirement for Variable Charges). The interrogatory response further states that the Utility will have the ability to "audit" the variable charge pursuant to section 7.5. Although section 7.5 allows the Utility to examine records "to verify the accuracy of any statement, charge, computation or demand made pursuant to any provisions of the [Contract]", it is not clear that this provides any remedy for excessive Variable Charges.

[53] Ibid., page 11
[54] Applicant's response to OEB staff interrogatory No. 41 a)

Section 4.1(c) of the Contract requires the Utility to pay all of the costs (without mark-up) for the truck transportation services for transporting LNG from the Nipigon LNG facility to the Utility's depots. However, the costs are not specified. In an interrogatory response, the Applicant estimated that these costs would be approximately $2.54 per kilometer, or approximately $0.84 per GJ[55]. The response noted, however, that this was not a firm price, and the final price will be subject to commercial negotiations following receipt of conditional approval of the application. It is important to note that Nipigon LNG will not itself provide the truck transportation service – it will negotiate with a third party for provision of that service[56]. OEB staff understands that the Utility will not be a party to those negotiations[57].

One area of the Contract where the financial terms are very clear is the "Firm Capacity Charge". This is a minimum set amount that the Utility is required to pay for a certain amount of natural gas every day; the amount varies by year, starting at 2,400 GJ/Day in year 1 and increasing to 3,700 GJ/Day in year 10. The Firm Capacity Charge Requires the Utility to pay a firm capacity charge of $7.03 per GJ for these volumes. This is a minimum charge, and must be paid irrespective of whether the gas is actually required or delivered (in other words, a "take or pay" arrangement). In year one of the Contract, for example, the Firm Capacity Charge will be $16,872 per day, or $6,158,280 for the year (plus HST)[58].

The Firm Capacity Charge allows Nipigon LNG "to recover the capital investment in the LNG facility which is allocated to [the Utility] in the proportion that the Customer's contractual Annual Minimum Volume bears to the aggregate of all annual volumes of all customers of the LNG Facilities."[59] OEB staff understands that the LNG facility has not yet been built, and OEB staff is unaware of any other current customers of Nipigon LNG.

The total estimated capital cost of the Nipigon LNG facility as proposed in Nipigon LNG's Natural Gas Grant Program (NGGP) application is $54 million; the amount of the NGGP grant is $27 million[60]. The firm capacity charge equates to approximately $86.7 million over first 10 years of the Contract. It appears to OEB staff, therefore, that the Firm Capacity Charge is designed to recover the entire capital cost of the LNG facility

[55] Applicant's response to OEB staff interrogatory No. 41 d)
[56] Applicant's Argument-in-Chief, page 43
[57] Applicant's response to OEB staff interrogatory No. 41 d)
[58] Exhibit A, Tab 13, Schedule 1, Attachment 5, Schedule B, pages 1-2 and Exhibit A, Tab 13, Schedule 1, page 12
[59] Exhibit A, Tab 13, Schedule 1, Attachment 5, page 15
[60] EB-2018-0248, Nipigon LNG Corporation's application for certificate of public convenience and necessity, response to Union Gas Limited interrogatory No. 1 c)

over the proposed 10-year contract term. Although Nipigon LNG intends to secure other customers over time, there is no provision for changing the Fixed Capacity Charge, if this were to occur, as it is fixed for the entire 10 year term of the Contract. OEB staff notes that if the Utility exercises the option to extend the Contract for an additional 10 year term, that the Fixed Capacity Charge will not decrease, but rather it will escalate by 1.5% annually.

OEB staff understands that some level of guaranteed payment is likely required to allow Nipigon LNG to make the financial commitment to build the LNG facility. OEB staff questions, however, whether it is reasonable for the entire capital cost of the facility to be assigned to the Utility, especially since Nipigon LNG intends to serve customers other than the Utility. OEB staff notes that Nipigon LNG is expected to have a liquefaction capacity of 7200 GJ/day. Under the Contract, the Utility will contract for 2400/GJ/day in year 1, increasing to 3700 GJ/day in year 10, which is 51% of Nipigon LNG's liquefaction capacity[61]. OEB staff further observes that the take or pay nature of the contract means that the Utility will be required to pay a minimum of $16,872 per day from day 1, irrespective of how many customers have signed up or been connected. This is a significant level of risk, not only to the Utility but to the customers to whom the Utility intends to pass all of these costs onto.

Section 3.1(iv) of the Contract requires the Utility to provide "financial security" to Nipigon LNG. The financial security can take a variety of forms (for example, a letter of credit from a bank), but has to be sufficient to cover the remaining obligation under the Contract[62]. In a response to an interrogatory, the Applicant confirmed that financial security would be required, but was unable to provide any estimate of the cost of this security[63]. The purpose of the financial security is to ensure that Nipigon LNG recovers the entire 10 year Firm Capacity Charges, even if the Contract is terminated (for whatever reason) prior to the end of the 10 year term[64]. As the annual amount of the Fixed Capacity charge is $6,158,820 in year 1 and rises to $9,494,015 in year 10, this is a very significant amount of security. OEB staff expects that the cost of this security could be quite substantial, especially given some of the risks the Utility faces (discussed in both this and other sections).

As financial security is one of the terms of the Contract, it appears that the Applicant is seeking OEB approval to pass the costs of the financial security on to customers. OEB

[61] Applicant's response to SEC interrogatory No. 14
[62] The various forms of Financial Security are defined at page 4 of the Contract
[63] Applicant's response to OEB staff interrogatory No. 37 d)
[64] Exhibit A, Tab 13, Schedule 1, Attachment 5, page 4

staff submits that it is not reasonable to approve this request without knowing what these costs will be.

Apportionment of Risk

OEB staff makes the overall observation that the Contract appears very much designed to protect Nipigon LNG from risk, and much less so to protect the Utility and therefore its ratepayers. It is OEB staff's understanding that the Nipigon LNG facility has not yet been built, but that the Utility is expected to be its main customer, at least during the early years of operation. The contract is designed such that it will cover most (or perhaps the entire) capital cost of the LNG facility. As such, the Applicant should have significant bargaining power and leverage in securing reasonable terms. OEB staff recognizes that the Town of Marathon cannot simply dictate terms, but it appears that there are areas where its leverage was not fully brought to bear.

As an example, section 10.3 of the Contract allows Nipigon LNG to terminate the Contract if (amongst other things) Nipigon LNG itself fails to obtain the regulatory and government approvals necessary to operate the LNG facility. Section 10.4 further provides that if the Contract is terminated, the Utility will be required to pay all of the costs accrued by Nipigon LNG for the construction and development of the LNG storage depots. In other words the Utility can be on the hook for significant (though unspecified) costs even if the project does not go forward on account of Nipigon LNG's failure to obtain all necessary approvals.

In another example, section 12 of the Contract provides that Nipigon LNG will not be responsible for any claims, losses, damages, etc., suffered by the Utility related to Nipigon LNG's conduct except where there has been "gross negligence or willful misconduct." The Utility, however, is responsible for any and all of Nipigon LNG's claims, losses, etc., related to the Utility's conduct irrespective of whether any negligence was involved. There is also a cap on the amount of Nipigon LNG's potential liability, but no cap on the Utility's potential liability.

OEB staff asked about the provisions of Sections 10 and 12 in interrogatories 43 and 44. The Applicant responded:

> The LNG Service Agreement represents the terms and conditions required by Nipigon LNG as a condition to the design, development and construction of the LNG Depot and subsequent provision of the LNG Services to the Utility. However, the LNG Services Agreement has not yet been signed and to the extent Board approval is conditioned on the amendment of certain terms of the

LNG Services Agreement, such discussions can be undertaken with Nipigon LNG.

The answer appears to be that these are the provisions of the Contract because this is what Nipigon LNG required. The response leaves open the possibility that these provisions could be re-negotiated if the OEB expresses discomfort.

Initial Term of the Contract

OEB staff also has concerns over the duration of the initial contract with Nipigon LNG. OEB staff believes that a longer initial term (15 years instead of 10 years) would better align the contract duration with the life span of the assets and would generate further annual savings for customers as fixed cost recovery would be spread over a longer period of time. In fact, the Applicant has estimated that extending the 10 year contract to 15 years and 20 years would reduce all-in residential bills by 3.7% and 6.3%, respectively[65] (assuming that the OEB finds that it is reasonable for the entire capital cost of the Nipigon LNG facility be paid for by the Utility's ratepayers).

Submission with respect to approving the cost consequences of the Contract

OEB staff appreciates that the OEB is not a party to the Contract and that the Applicant does not require any approval from the OEB to execute the Contract. The OEB also has no power to re-negotiate a contract. However, the Applicant is seeking pre-approval to have the cost consequences of the Contract passed on to ratepayers. OEB staff submits that the OEB should not approve the cost consequences of the Contract as it is currently drafted. As described above, many of the costs are not actually known at this point, and it would not be appropriate for the OEB to approve cost consequences where it does not know what those costs will be. OEB staff is also concerned about the apportionment of risk between Nipigon LNG and the Utility (and by extension ratepayers). Finally, OEB staff questions whether it is reasonable for the Utility's ratepayers to cover the entire capital cost of the Nipigon LNG facility, when they are expected to be only one of the users of that facility.

The OEB could consider approving a portion of the cost consequences of the Contract. For example it could approve the cost consequences of the Firm Capacity Charge (or a portion thereof, if the OEB believes it is unreasonable for the Utility's customers to pay 100% of the capital costs of the Nipigon LNG facility) as set out in the Contract.

[65] Applicant's response to OEB staff interrogatory No. 46 c)

Similarly, the OEB could consider capping the Variable and Trucking Charges at the lower of:

i. the amounts estimated in the Application and interrogatory responses; and

ii. the results of a competitive procurement process

For example, if the actual procurement for Trucking costs results in lower costs than the Applicant estimated, those savings could get passed on to customers. Otherwise the costs would be capped at the Applicant's estimate, which would avoid the OEB approving a currently unknown amount. In OEB staff's view, completely unknown costs, such as the cost for financial security, should not be approved.

OEB staff's proposed approach does not mean that the Utility would be barred from seeking to recover these costs in a future rates application. However, pre-approval of the cost consequences of a gas supply contract is an exception to the OEB's ordinary practice. The OEB should only pre-approve costs where it has reasonable certainty as to what those costs will be, and that it is confident that the costs themselves are reasonable.

5 CONCLUSION

In OEB staff's view, the Project has potential to benefit the Municipalities by increasing energy options for local consumers and helping to reduce their energy costs. The project may also improve the local economies of the Municipalities.

The application as proposed, however, is subject to a number of unmitigated risks that appear to fall disproportionately on potential natural gas ratepayers. OEB staff is not opposed to the OEB's approval of Phase I of the application, subject to the implementation of OEB staff's proposed mitigation measures, which were explained throughout this submission and are summarized below.

1. The LTC application should not receive final approval until the Applicant or Utility has filed information in Phase II of the application (or prior) regarding the following, and that information is deemed acceptable by the OEB:
    a. Evidence of a letter of credit or similar financial security from the industrial customer
    b. A letter from MENDM confirming that the Applicant's Indigenous consultations to date have been sufficient to discharge the Crown's Duty to Consult

c. Evidence that the omissions in the Applicant's land use agreements have been addressed

d. Filing of the final version of the EPP

e. The filing of maps that address the concerns raised by OEB staff

f. Evidence that the Applicant and Nipigon LNG have renegotiated the Contract and that OEB staff's concerns regarding uncertain costs and an unequal allocation of risk have been renegotiated and addressed

g. The OEB should not approve the cost consequences of the Contract as currently drafted. OEB staff's chief concerns relate to uncertain costs and an unreasonable allocation of risk as between the Utility and Nipigon LNG. However, OEB staff suggests that the following cost consequences would be reasonable:

    i. The costs associated with a longer Contract term (e.g. 15 years instead of 10 years)

    ii. The costs associated with lowering the Firm Capacity Charge below $7.03 per GJ to ensure the Utility's ratepayers are not covering the entire capital cost of the Nipigon LNG facility

    iii. Capping the Variable Charge at $0.34 per GJ (which is not specified in the Contract as currently drafted)

    iv. Capping the truck transportation service charge at $2.54 per kilometer (which is not specified in the Contract as currently drafted)

    v. Not pre-approve any other costs in the Contract, such as the cost for financial security. This is not to say that these costs would necessarily be unrecoverable through a rates proceeding, but that the OEB should not pre-approve them under the terms described in the current Contract.

2. The Utility should be required to provide a 10-year rate stability period during which it assumes risks associated with the customer forecast and capital overruns.

3. The LTC should be conditional on approved rates, and the Applicant should be required to file its rate application under separate cover but at the same time it files its technical and financial information for Phase II of the application.

4. The Applicant should be required to install facilities to enable it to receive secondary sources of LNG and CNG downstream of the LNG Depots

All of which is respectfully submitted.

Appendix A

Leave to Construct Conditions of Approval
Corporation of the Town of Marathon
EB-2018-0329

The Corporation of the Town of Marathon (Corporation), the Township of Manitouwadge, Township of Schreiber, Township of Terrace Bay and the Municipality of Wawa (Municipalities) have resolved to incorporate, finance and resource a yet to be created utility (Utility) to distribute natural gas within their municipalities.

1. Authorization for leave to construct is granted conditional upon the OEB's final approval of the Corporation's application for certificate of public convenience and necessity, which will be decided after the OEB has considered the information filed to demonstrate the Utility's technical and financial abilities.
2. Construction of the facilities shall not begin until all certificates, franchises and leave to construct have been transferred to the Utility.
3. The Utility shall construct the facilities and restore the land in accordance with the OEB's Decision and Order in EB-2018-0329 and these Conditions of Approval.
4. (a) Authorization for leave to construct shall terminate 24 months after the final decision is issued, unless construction has commenced prior to that date.

   (b) For each of the Municipalities, the Utility shall give the OEB separate written notice:

   i. Of the commencement of construction, at least ten days prior to the date construction commences
   ii. Of the planned in-service date, at least ten days prior to the date the facilities go into service
   iii. Of the date on which construction was completed, no later than 10 days following the completion of construction
   iv. Of the in-service date, no later than 10 days after the facilities go into service
5. The Utility shall implement all the recommendations of the Environmental Report filed in the proceeding, and all the recommendations and directives identified by the Ontario Pipeline Coordinating Committee review.
6. The Utility shall advise the OEB of any proposed change to OEB-approved construction or restoration procedures. Except in an emergency, the Utility shall not make any such change without prior notice to and written approval of the OEB. In the event of an emergency, the OEB shall be informed immediately after the fact.

7. Concurrent with the final monitoring report referred to in Condition 6(b), the Utility shall file a Post Construction Financial Report, which shall provide a variance analysis of project cost, schedule and scope compared to the estimates filed in this proceeding, including the extent to which the project contingency was utilized. The Utility shall also file a copy of the Post Construction Financial Report in the proceeding where the actual capital costs of the project are proposed to be included in rate base or any proceeding where the Utility proposes to start collecting revenues associated with the project, whichever is earlier.

8. Both during and after construction, the Utility shall monitor the impacts of construction, and shall file with the OEB one paper copy and one electronic (searchable PDF) version of each of the following reports:

   a) A post construction report, within three months of the in-service date, which shall:

      i. Provide a certification, by a senior executive of the company, of the Utility's adherence to Condition 1

      ii. Describe any impacts and outstanding concerns identified during construction

      iii. Describe the actions taken or planned to be taken to prevent or mitigate any identified impacts of construction

      iv. Include a log of all complaints received by the Utility, including the date/time the complaint was received, a description of the complaint, any actions taken to address the complaint, the rationale for taking such actions

      v. Provide a certification, by a senior executive of the company, that the company has obtained all other approvals, permits, licences, and certificates required to construct, operate and maintain the proposed project

   b) A final monitoring report, no later than fifteen months after the in- service date, or, where the deadline falls between December 1 and May 31, the following June 1, which shall:

      i. Provide a certification, by a senior executive of the company, of the Utility's adherence to Condition 3

      ii. Describe the condition of any rehabilitated land

      iii. Describe the effectiveness of any actions taken to prevent or mitigate any identified impacts of construction

      iv. Include the results of analyses and monitoring programs and any recommendations arising therefrom

      v. Include a log of all complaints received by the Utility, including the date/time the complaint was received, a description of the complaint, any actions taken to address the complaint, the rationale for taking such actions[66]

[66] In response to OEB staff interrogatory 18 a), the Applicant volunteered to make a post-construction filing with the OEB that provides evidence of landowner satisfaction with post-construction clean-up when complete[66]. OEB staff submits that this information could be made available as part of this post-construction report.