April 27, 2021

Christine Long
Registrar
Ontario Energy Board
2300 Yonge Street
P.O. Box 2319
Toronto, Ontario
M4P 1E4

Dear Ms. Long:

**EB-2020-0150 - NextBridge Infrastructure LP – East-West Tie Line – 2022-2031 Rates**

Please find, attached, the Final Argument of the Consumers Council of Canada in the above-reference proceeding.

Yours truly,

**Julie E. Girvan**

Julie E. Girvan

CC: All Parties

**FINAL ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA**

**RE: NEXTBRIDGE INFRASTRUCTURE – TRANSMISSION – 2022-2031 RATES**

**EB-2020-0150**

On November 4, 2020 Upper Canada Transmission Inc. ("UCT") acting on behalf of NextBridge Infrastructure, LP ("Nextbridge") filed an Application to the Ontario Energy Board ("OEB") for approval of a transmission revenue requirement and a Custom Incentive Rate-setting ("Custom IR") framework for the period April 1, 2022 to December 31, 2031.

NextBridge is a new Ontario transmitter constructing the 450 km East-West Tie between Thunder Bay and Wawa in Northwestern Ontario which will interconnect to three Hydro One Networks Inc. ("HON") transformer stations ("TS") at Lakehead TS, Marathon TS and Wawa TS.[1]

In its Decision and Order dated February 11, 2019, the OEB granted NextBridge leave to construct the East-West Tie line. The approval was granted following a directive by the Minister of Energy, Northern Development and Mines as well as an Order in Council dated January 30, 2019 approving the directive. The Minister required the OEB to amend the conditions of NextBridge's transmission licence to include a requirement to "develop, seek approvals in respect of, and proceed with immediacy to construct, expand or reinforce the new transmission line between Wawa and Thunder Bay."[2]

Through this Application NextBridge is seeking approval of the following:

- A Revenue Cap Index ("RCI") framework for the period April 1, 2022 to December 31, 2031 which includes a rate adjustment of 2% per year beginning on January 1, 2023;
- A base Revenue Requirement for the period April 1, 2022 to December 21, 2022 of $41.8 million;
- Implementation of the revenue requirement and the rates that flow from it through the OEB's approved Uniform Transmission Rates for the Network pool;
- Recovery of $31.24 million in development costs approved by the OEB's Decision and Order dated December 20, 2018 (EB-201-0182);
- Recovery of $5.331 million of pre-July 31, 2017 in Phase Shift Costs;
- Recovery of $737.1 million of construction costs;
- Recovery of $1.2 million in spares;
- Inclusion in the UTR for the Network pool for nine months of service beginning April 1, 2022;

[1] Exhibit B-1-4
[2] EB-2017-0182/0194/0364 Decision and Order dated February 11, 2019, pp. 5-6

- The establishment of the accounting orders for a construction cost variance account ("CCVA");
- The establishment of the accounting orders for a debt rate variance account ("DRVA") to track the one-time update to the cost of long-term debt in 2023 to reflect the actual cost of debt associated with the financing of the East-West Tie line;
- The establishment of the accounting orders for taxes in lieu of taxes variance account ("PILsVA") effective April 1, 2022;
- The establishment of the accounting orders for a revenue differential variance account ("RDVA") effective April 1, 2022; and
- The establishment of a Z-factor account if material costs are incurred for unforeseen events for reasons beyond the company's control that occur during the IR term.[3]

These are the submissions of the Consumers Council of Canada ("Council") regarding NextBridge's Application. The Council will first set out context for the OEB's consideration of the Application and then address the major issues. The Council does not intend to comment on every issue as our submissions will focus primarily on the proposed rate framework.

**CONTEXT:**

This is a unique Application. NextBridge has been granted Leave to Construct the East-West Tie based on a decision by the OEB pursuant to a directive from the Minister of Energy, Northern Development and Mines. The Independent Electricity System Operator determined that the East West Tie line was the best option to meet Northwestern Ontario electricity supply needs when compared to other alternatives. The project has been approved and the forecast construction costs of $737.1 million are consistent with the costs presented to the OEB in the leave to construct proceeding[4]. The project is on track with a proposed in-service date of April 1, 2022. The OEB must now decide the appropriate rate-setting mechanism that will allow Nextbridge to recover the costs of the project.

The most important fact for the OEB's consideration of the Application is that Nextbridge is a new single asset transmission utility, that has declining costs and a declining rate base over the rate plan term. Accordingly, the rate plan approved by the OEB should be designed to reflect this fact. NetxBridge's rate proposal as set out in its Application effectively increases the revenue requirement each year by 2%, which will result in earnings well beyond what would normally be allowed.

The OEB over many years has approved a number of Custom IR proposals. Those include proposals by Hydro One Networks Inc./Transmission, Hydro One Networks Inc./Distribution, Toronto Hydro-Electric System Limited, Enbridge Gas Distribution Inc., Union Gas Limited and the newly combined entity, Enbridge Gas Inc. Those have been based on an I-X approach with mechanisms to recover incremental capital (including capital factors and incremental capital

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[3] Exhibit A/T2/S1 pp/ 2-4

[4] Decision and Order – EB-2017-0182/0194/0365

modules. Those utilities have had increased capital needs during their rate plan term. They cannot and should not be comparable to NextBridge.

The OEB has approved rate plans for B2M LP and Niagara Reinforcement LP.[5] Those rate plans were the result of settlement negotiations, with limited involvement by ratepayer intervenors. In addition, the Council notes that in both these cases the revenue requirement actually increases in each year. As will be demonstrated in this case that is not appropriate for NextBridge as its rate base and costs will actually decline each year. 91% of the proposed revenue requirement relates to capital related costs[6], so to inflate the overall revenue requirement would be counterintuitive. The Council submits that a model which accounts for the declining rate base is clearly appropriate for NextBridge.

**RATE FRAMEWORK:**

**The IR Formula:**

NextBridge has developed a Custom IR that is based on a Revenue Cap Index ("RCI"). The first step in this approach is to set a base revenue requirement for 2022 determined on a cost of service basis. That base revenue requirement (annualized) is $55.7 million. The RCI formula includes an Inflation Factor of 2% and a Productivity Factor of 0%. This formula is applied each year for the full term of the rate plan. Using NextBridge's approach the entire revenue requirement (which includes operating, maintenance, and administration and capital costs) will be increased by 2% per year for the entire term of the plan.

NextBridge has claimed that this approach is appropriate considering the OEB's expectations for incentive regulation and considering the Project's value to customers. Nextbridge has claimed it benefits customers for the following reasons:

- Transmission revenues will be locked in at a low base to which a low inflation rate will be applied for almost 10 years;

- A currently low cost of capital will be locked in for close to 10 years which may result in significant customer savings;

- NextBridge is responsible for any increases in OM&A above the 2% inflation factor;[7]

In its Argument in Chief NextBridge lists known and unknown potential OM&A cost increases that it will be subjected to during the plan. Ms Tidmarsh, on behalf of Nextbridge, throughout the hearing, continually referred to these "risks" as potentially subjecting Nextbridge to "death by 1000 cuts." As will be demonstrated below these risks have been overstated, potentially

[5] EB-2018-0275 and EB-2019-0178
[6] Transcript Vol. 1, pp. 38-39
[7] Argument in Chief, p. 12

applicable for Z-factor treatment, and would represent a relatively small part of the overall costs of this project.

For the reasons set out below the Council completely disagrees with NextBridge's contention that its approach to rate-making is appropriate and that it provides value to customers. NextBridge is a single asset transmission utility with its rate base and overall costs declining every year. The application of an I-X approach that increases the revenue requirement each year by 2% cannot be justified. If the OEB were to approve such an approach it would not result in just and reasonable rates for Ontario transmission customers. It is important that the OEB approve an approach that establishes an appropriate balance between the interests of NextBridge's shareholders and Ontario transmission customers.

During the proceeding Counsel to the School Energy Coalition ("SEC") presented an analysis which set out the revenue requirement that would be collected under NextBridge's proposed rate-setting model (assuming a 2% increase in the revenue requirement per year) and its forecast costs to the end of the rate plan period (2031). In that analysis the gap between what NextBridge proposes to collect is a base revenue requirement of $596.2 million. The overall costs, based on NextBridge's own forecast of its capital-related costs and OM&A costs is $528.1 million. This represents a gap of $68.1 million.[8]

Based on this analysis SEC also provided an estimate of the expected Return on Equity ("ROE") (relative to that embedded in rates) for each year over the rate plan period. What that analysis demonstrates is that over time, as NextBridge's costs go down (as the assets are depreciated), and the revenue requirement goes up (as per the formula) it will overearn. The overearning will in fact increase over time with NextBridge earing an ROE in 2031 if 13.75%.[9] The SEC analysis which is set out in more detail in SEC's final submissions clearly demonstrates that NextBridge's approach is misguided and not appropriate. This is not simply a spreadsheet, but a solid analysis that should be accepted by the OEB.

The Council submits that the adjustments to NextBridge's proposed base revenue requirement should done in two parts. The Council accepts that the approved OM&A costs (discussed below) will be subject to inflationary increases. However, there should be a stretch factor included in order to incent productivity. Allowing NextBridge to escalate its OM&A at the rate of inflation is not consistent with incentive regulation or any of the OEB's previously improved Custom IR plans.

With respect to the capital-related revenue requirement, which represents 91% of the total, the Council supports a factor that would reduce the amount each year. The Council has been in discussions with SEC regarding this issue and supports its approach to use an annual adjustment factor for capital that reflects the average yearly reduction in the forecast capital-related revenue requirement. That factor is 0.9%. In effect, the capital related revenue requirement is

[8] Exhibit K1.2 pp. 56-57

[9] Exhibit K1.2, p. 57

reduced by this amount each year. This approach is fair to both NextBridge and Ontario's transmission customers. The Council urges the OEB to accept this approach.

**BASE REVENUE REQUIREMENT:**

**Capital:**

Nextbridge is seeking approval of a rate base of $770.4 million. This includes construction costs, phase shift costs, spares and the development costs that were approved by the OEB in the designation proceeding.

Nextbridge's proposed construction costs are $737.1 million which is consistent with the amounts projected in the previous leave to construct proceeding. At the time of the hearing 60% were actually incurred with 90% secured under contract[10]. At the time NextBridge was designated the construction cost forecast was $409 million.[11] In its February 11, 2019 Decision approving the leave to construct application the OEB noted that its Decision and Order should not be taken as accepting the level of costs of the NextBridge project for the purposes of recovery from ratepayers. The OEB indicated that NextBridge would have to demonstrate the prudence of its costs when seeking to recover those costs in the future[12].

NextBridge has set out the following arguments in support of the $737.1 million:

- NextBridge's cost management and procurement practices resulted in securing nearly 90% of its forecasted $737.1 million construction costs under contract which reduced future volatility in pricing and ensured resource availability due to the contracts having an agreed upon price and negotiated scope of work;

- The remaining 10% of the forecasted construction costs related to internal parent and partner labour that support the East-West Tie line or already/committed costs, such as those related to land and are being managed consistent with the overall forecast of $737.1 million;

- Through NextBridge's application of proactive cost and procurement management practices the overall projected construction costs of the East-West Tie line have not changed from the Leave to Construct proceeding;

- For these reasons, as well as substantial evidence set forth in the Application and quarterly report demonstrating that NextBridge construction costs are tracking the $737.1 million, absent an unforeseeable event(s), NextBridge is confident that the East-

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[10] Argument in Chief, p. 32
[11] EB-2017-0182/0194/0364/Decision and Order, dated February 11, 2019, p. 7
[12] Ibid

West Tie line will come into service on or before March 31, 2022 at a cost of $737.1 million.[13]

Given that 90% of the construction costs have been spent or are currently under contract the Council has no reason to take issue with the construction cost estimate of $737.1 million. In its Quarterly Report filed with the OEB on April 22, 2021 NextBridge stated that, "Known construction costs for the EWT Project are forecast to be on budget as compared to the LTC application." The one exception are the costs associated with the COVID-19 Global Pandemic which will not be known well after construction is completed and the Pandemic is resolved.[14]

**Capital Construction Variance Account:**

NextBridge is seeking approval to record any additional construction costs in the construction cost variance account ("CCVA") for a prudence review and disposition in the second annual update following the in-service date.[15] NextBridge's position is that the CCVA is needed to track any change in the revenue requirement associated with the difference between the forecasted construction costs set forth in the Application and the actual, final construction costs, including interest during construction. In addition, the CCVA would track costs related to construction that are incurred after the March 31, 2022 in-service date before the end of the IR term, such as environmental compliance costs required by commitments in the Overall Benefits Permit ("OPB") or the Amended Environmental Assessment and are not known or included in the construction cost forecast. The proposal is to keep the CCVA open for the entire term.

The Council is not opposed to the creation of the account, but does not support it being a symmetrical account. We have heard repeatedly, throughout this proceeding that NextBridge is confident in its forecast costs. It has gone as far as saying there is "no uncertainty".[16] The OEB should approve the costs as proposed.

The CCVA proposed by NextBridge is effectively a capital pass-through account. Whatever NextBridge spends gets recorded in the account, albeit subject to a prudence review. This is not how utility regulation works, or specifically how Custom IR plans have been structured in Ontario. Utilities forecast their costs and are required to live with those forecasts over a the rate plan term (subject to any adjustments made by the OEB). Upon rebasing the regulator undertakes a prudence review of the actual costs incurred prior to their inclusion in rate base.

Given NextBridge's confidence in its cost projections, and the fact that 90% of its costs are either spent or contracted there is no justification for a symmetrical CCRA. The Council does, however, support an asymmetrical account which would effectively act as a ratepayer protection mechanism to the extent NextBridge's costs have been overstated. Such an account

[13] Argument in Chief, pp. 32-33
[14] Quarterly EWT Progress Report dated April 22, 2021, p. 3
[15] Ibid, p. 33
[16] OEB Staff – 52, p. 2

would ensure that ratepayers are effectively not paying for costs that were never incurred. This type of account has formed part of approved Custom IR plans for both Hydro One Networks Inc. (both for Distribution and Transmission) and Toronto Hydro-Electric System Limited.

Although the Council is opposed to a symmetrical CCVA there are costs, beyond the control of NextBridge that should be subject to deferral account treatment. These are the OPB and Amended EA costs. These are unknown environmental compliance costs that have not been included in the current construction cost forecast.[17] The fact that they are unknown, subject to Ministry permits and beyond the control of NextBridge justifies deferral account treatment.

In addition, the Council supports deferral account treatment for the COVID-19 Global Pandemic costs, which will not be known until after the construction phase and after the pandemic is resolved. The recovery of these costs, which are unknown at this time will be the subject of a future proceeding.

**Operating, Maintenance and Administration Costs**:

Nextbridge is seeking, as part of it proposed revenue requirement, OM&A costs totalling $4.94 million.[18] The Council is not taking issue with the proposed OM&A costs. The Council does believe, however, that the level of proposed OM&A costs, which will increase over the term of the plan through the RCI, should be sufficient given the fact that NextBridge is a single asset utility.

In its effort to justify its proposed rate plan to increase the revenue requirement each year Nextbridge has claimed that it "purposely set forth **minimal** Test Year OM&A cost in order to provide direct savings to customers".[19] However, repeatedly throughout the evidence NextBridge claims that it will be subject to a long list of known and unknown cost increases[20]. NextBridge's evidence on this point is as follows when asked by OEB Staff why a rate freeze or declining revenue requirement would not be sufficient to recover its allowed costs:

> No, freezing the rates revenue requirement will not allow NextBridge to recover it costs and earn its allowed return on capital. NextBridge forecasts that the incremental cost pressures offset the lower capital costs due to a falling rate base over the rate period. Additionally, the HONI SLA and NEET services are not fixed price contracts, rather they are a budgeted estimate of services based off the currently understood maintenance[21].

The analysis provided by SEC comparing the proposed costs to what NextBridge proposes to collect as a base revenue requirement demonstrates that the incremental cost pressures will

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[17] Transcript Vol. 1, pp61-63 and Argument in Chief, p. 42
[18] Exhibit A-3-1, p. 5 F-1-1
[19] Argument in Chief, p. 13
[20] Exhibit A-3-1, p. 2 and OEB Staff - 4
[21] Exhibit OEB Staff-4

not offset the lower capital costs due to a falling rate base. Only if those cost pressures exceeded $60 million would that be the case.
Nextbridge identified the following internal and external cost pressures:

- Rising income tax expense as NextBridge's capital cost allowance declines;
- Managing NextBridge's right-of-way vegetation management taking into account the six-year vegetation schedule;
- Potential maintenance and labour cost increases;
- Bird nest removal and bird excrement-associated damages;
- Localized extreme weather event(s) and associated remediation;
- Fixed Consumer Price Index for reserve crossing permits may not align with inflation;
- New First Nations Reserve Land that could be added to the land base of the East-West Tie line requiring new Federal agreements and payments;
- Unexpected damage from right-of-way users or wildlife; and
- Potential compliance changes through the North American Reliability Corporation which will flow through the Northeast Power Coordinating and the IESO.[22]

This was referred to by Ms. Tidmarsh repeatedly as "death by 1000 cuts"[23]. When asked to quantify these costs she could not, and she indicated that NextBridge had not undertaken any sensitivity analysis with respect to these items.[24] NextBridge is basing much of the justification for its rate plan, which increases the revenue requirement each year despite a declining rate base on these unknowns, but has not provided any forecast costs for these potential risks. What Ms. Tidmarsh did say is that not a single one of these items would put us over a Z-factor threshold.[25] NextBridge's materiality threshold is $278,500.[26]

The Council submits that the OEB should accept NextBridge's OM&A costs as filed. We note the comment from Mr. Mayers that NextBridge is confident that it can keep the OM&A levels at the $4.94 million. [27] Obviously NextBridge put forward a budget in which it has confidence. To the extent it is subjected to unforeseen costs that are beyond its control and material it has an opportunity to apply for Z-factor relief as long as the materiality threshold is met. Generally, every utility is subject to cost pressures during an IRM term and if those cost pressures are beyond its control and material, they can apply for cost recovery through the Z-factor.

**Cost of Capital:**

[22] Listed in OEB Staff-4
[23] Transcript, Vol. 1 pp. 134,135,145,149,165 and Volume 2, p. 8
[24] Transcript Vol. 2, pp. 6-9
[25] Transcript Vol. 2, p. 6
[26] Exhibit A-3-1 p. 21
[27] Transcript Volume 1, p. 151

NextBridge is proposing to use the return on equity rate of 8.52% based on the OEB's approved rate for 2020 rates. The Council submits that in line with OEB policy NextBridge should be required to use the rate approved by the OEB for 2022 rates.

With respect to debt costs the Council supports the establishment of the Debt Rate Variance Account to allow NextBridge to update the long-term and short-term debt rates to reflect its actual debt rates once that debt is secured closer to the in-service date of the project.

**OTHER ISSUES:**

**Earnings Sharing:**

NextBridge did not include an earnings sharing mechanism ("ESM") as part of its Custom IR for the following reasons:

- It is a unique as a single asset transmitter and has a unique IR term of 9 years and 9 months;
- There is already an OEB appointed trigger of 300 bps for overearning;
- NextBridge will report earnings annually and the OEB will have visibility into overearnings;
- This is a new transmission line – there is exposure for unplanned expenses that may mitigate over earnings.[28]

The Council has submitted that the OEB should reject NextBridge's proposal to implement a Custom IR plan that increases its revenue requirement over time given its rate base will be declining. Imposing an ESM on NextBridge will not provide a solution to what is a fundamentally flawed rate-setting mechanism. The formula needs to be changed.

Once the RCI is adjusted the Council is of the view that an ESM should also be a required element of the Custom IR plan. NextBridge has argued that OEB policy does not make an ESM mandatory.[29] The Council notes, however, that asymmetrical ESMs are a feature of most, if not all, Custom IR plans approved by the OEB. They provide important ratepayer protection against significant overearnings. They also allow for ratepayers to benefit from any productivity improvements achieved over the rate plan term. Under NextBridge's proposals ratepayers have no opportunity to share in any productivity.

NextBridge appears to saying that the Off-Ramp element of its plan should be sufficient to guard against significant overearning. Ms. Walding stated that, "We would expect to have a regulatory review if we stayed at 300 basis points."[30] If NextBridge reached an ROE that was 290 basis points above its allowed return, all of those earnings would flow to the shareholder.

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[28] Exhibit OEB Staff - 66
[29] Argument in Chief, pp. 17-18
[30] Transcript Volume 2, pp. 4-5

NextBridge argues that given its RCI already mitigates against significant earnings because of its commitment to add capital and cost manage internal and external cost pressures while holding OM&A at a minimal Test year baseline it has not proposed an ESM. The Council urges the OEB to reject that position. ESMs should, from the Council's perspective, by a required element of every Custom IR plan.

**Rate Term:**

NextBridge has proposed a rate term of 9 years and 9 months. Its justification is that it is appropriate, as it provides rate stability and other tangible benefits to customers and is consistent with OEB policy[31].

The Council supports a term of 5 years. Frankly, this is based on a perspective that 10 years (or 9 years and 9 months) is simply too long a period of time for utilities to avoid regulatory oversight. The Council is of the view that if the regulatory model is benefiting NextBridge it will choose to "stay out" and avoid regulatory scrutiny as long as possible. If it is not, it will come back before the OEB at its discretion requesting relief. Refreshing the revenue requirement after 5 years is a prudent approach from the Council's perspective as the electricity sector has proven a lot can change over 10 years.

**COSTS:**

The Council requests that it be awarded its reasonably incurred costs for its participation in this proceeding.

**All of which is respectfully submitted.**

[31] Argument in Chief, p. 18