Submission of Enbridge Consumers Gas, Union Gas Ltd., And Natural Resource Gas

Model Franchise Agreement

Ontario Energy Board Proceeding RP-1999-0048

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Table of Contents

INTRODUCTION 1

GUIDING PRINCIPLES FOR MODEL FRANCHISE AGREEMENT 1

POSITIONS AND EVIDENCE ON SPECIFIC ISSUES 3

PAYMENT OF PERMIT FEES AND/OR RIGHTS-OF-WAY FEES 3
DURATION OF NEW AND RENEWAL FRANCHISE AGREEMENTS 5
INSURANCE AND LIABILITY 6
GEODETIC INFORMATION & AS BUILT DRAWINGS 7
NO WARRANTY AS TO CONDITION OF HIGHWAY 8
LEGISLATIVE CHANGE EFFECTS 9
DEFAULT PROVISIONS 10
ABANDONED GAS PIPE 11

CONCLUSIONS 11

Introduction

1. The Model Natural Gas Franchise Agreement ("Model Franchise Agreement") is critical to the orderly and reliable distribution of natural gas in Ontario. The Model Franchise Agreement frames the relationship and obligations between Ontario's gas distribution companies and its municipalities. However, the terms and conditions of the Model Franchise Agreement significantly impact natural gas customers, the Ontario economy, and its natural environment.

2. The current Model Franchise Agreement has served Ontarians well since it was established in 1987. It has facilitated the economic expansion of low-cost natural gas to thousands of households, businesses, and communities. The Model Franchise Agreement has assisted Ontario and its local communities in achieving economic development and environmental objectives.

3. The new Model Franchise Agreement, which will be established under proceeding RP-1999-0048, should be designed to achieve these same broad objectives. Any potential changes to the Model Franchise Agreement should be considered broadly for their impacts on customers, the energy industry, the Ontario economy, and its environment.

4. The broad public interest is as important in this regulatory proceeding as in others. In reviewing the Model Franchise Agreement, the Ontario Energy Board ("The Board") should not merely contemplate the tradeoffs between gas distribution companies and municipalities. As in other proceedings, the Board should balance the impact of any changes on the Ontario economy, natural gas customers, and other stakeholders.

5. The following submission is made jointly by Enbridge Consumers Gas, Union Gas Ltd., and Natural Resource Gas ("The Gas Companies"). The submission sets out suggested guiding principles for the Model Franchise Agreement, and addresses the ten specific issues on which the Board requested comments.

Guiding Principles for Model Franchise Agreement

6. The Model Franchise Agreement is one of many components of the Ontario energy industry under review at this time. Significant legislative and regulatory reforms have been adopted and are expected to continue into the future. A key challenge is to ensure that all facets of the energy industry in Ontario, including the Model Franchise Agreement, are reformed in a consistent manner.

7. A consistent set of guiding principles has thus far been critical to meeting this challenge. The principles of ensuring a low-cost supply of energy, expanding choice for energy customers, and maintaining a level playing-field between gas and

electricity, have all guided Ontario's energy industry reforms to date. These same principles should guide the consideration of reforms to the Model Franchise Agreement.

- **Ensuring a Low-Cost Supply of Energy –** Providing a low-cost supply of gas and electricity has been fundamental to Ontario's energy reforms. The *Energy Competition Act* is designed to promote competition and an entrepreneurial spirit that will drive down costs in Ontario's energy industry. In turn, these cost savings are meant to benefit customers in the form of stable or lower rates.

  Regulatory reforms and decisions have also promoted a lower cost structure and lower rates. Performance based regulation and unbundling decisions will promote innovation and competition, thereby reducing costs that are passed through to energy customers across the province. It is the Gas Companies position that decisions with respect to the Model Franchise Agreement should similarly promote efficiency and a lower cost structure.

- **Expanding Choice for Energy Customers –** Legislative and regulatory reforms have been designed to increase customer choice. In particular, unbundling in the electricity and natural gas sectors will increase competition and choice in the retail market.

  The ability to choose between natural gas and electricity is an option that many customers value as much as any other choice of product or service. However, customers in many small communities and rural areas are still without a supply of natural gas. Any reforms to the Model Franchise Agreement should preserve the potential for increased customer choice through the expansion of natural gas to new communities.

- **Maintaining a Level Playing Field Between Gas and Electricity –** The need to minimize cost inequities and other market inequities between gas and electric utilities has been a key consideration in Ontario's energy reform. In the context of unbundling, and the development of new codes of conduct, not disadvantaging one form of energy relative to another has been a key principle. Common principles have also been drafted for the performance based regulatory framework that will apply to gas and electricity distribution companies alike.

  Level playing field considerations should similarly guide any reforms to the Model Franchise Agreement. Costs that are not borne by Ontario's electricity distribution companies should not be layered into the natural gas distribution cost structure. Such an action would undermine, and be inconsistent with, the careful balance struck by the Province and by the Board in concurrent energy sector reforms.

Positions and Evidence on Specific Issues

8. Early this year, the Gas Companies and The Association of Municipalities of Ontario (AMO) entered into discussions on potential revisions to the Model Franchise Agreement. The parties agreed on several amendments to the Model Franchise Agreement. These amendments are contained in the document entitled "Summary of Discussions Between AMO and the Gas Companies", submitted to the Board on September 24, 1999.

9. AMO also proposed certain amendments to the Model Franchise Agreement that were not agreeable to the Gas Companies. It is on the following ten issues for which there was no agreement, that the Board has indicated it wishes to receive comments:

1) Payment of permit fees
2) Compensation for the use of municipal rights-of-way
3) Duration of new and renewable franchise agreements
4) Insurance and liability
5) Geodetic information
6) As-built drawings
7) No warranty as to condition of highway
8) Legislative change effects
9) Default provisions
10) Abandoned gas pipe

10. The Gas Companies' comments on each of these issues are set out below. It should be noted that the first two issues, payment of permit fees and rights-of-way fees, are addressed together in the same section of this submission.

Payment of Permit Fees and/or Rights-of-Way Fees

11. Section IV(1) of the current Model Franchise Agreement specifically prohibits municipalities from levying permit fees on the Gas Companies. AMO has proposed that the Gas Companies pay a flat $350 fee for each permit issued by municipalities. AMO has also proposed that the Gas Companies pay right-of-way fees of $250 per kilometer of pipeline within municipalities.

12. The Gas Companies are opposed to any amendments to the Model Franchise Agreement that would allow municipalities to levy permit fees or rights-of-way fees. New permit fees and/or rights-of-way fees would add a layer of cost to the gas distribution business, exacerbate the cost inequities between gas and electricity distribution, and reduce the feasibility of new gas expansion projects.

13. Any permit fees and/or rights-of-way fees on the Gas Companies designed to raise new revenues would directly increase natural gas rates. Rather than paying more in

the form of property taxes, gas ratepayers would simply be paying more in the form of energy bills. The Gas Companies do not believe it is in the public interest to shift costs from the property tax bill to the gas bill.

14. The Gas Companies are opposed in principle to new municipal fees, regardless of their magnitude. However, it is worth noting that such fees could result in large cost and rate impacts. For example, under AMO's proposed new permit fees and rights-of-way fees, tens of millions of dollars of new cost could be passed on to gas ratepayers each year. The municipalities would also have an incentive to increase their revenues by requiring more permits for more activities, possibly resulting in substantial annual increases in distribution costs and gas rates.

15. The application of any new municipal fees would also exacerbate current municipal tax inequities between gas distribution companies and electricity distribution companies. Natural gas companies pay property taxes on their buildings, underground pipes, and service connections located on public and private lands. Electric utilities pay no municipal taxes on their systems of poles, underground plant, and distribution wires. Applying new fees to the gas sector would widen this tax gap, increase the cost of natural gas relative to electricity, and create a competitive disadvantage for gas distribution.

16. New municipal fees on gas distribution could reduce the amount of natural gas system expansion in Ontario. The economic feasibility of all expansion projects would be reduced if the AMO's proposed permit fees and occupation charges were allowed under the Model Franchise Agreement. Fees on construction permits, annual rights-of-way charges on new gas mains, and fees on maintenance permits required over the life of expansion projects, would all reduce the net present value of these expansion projects .

17. Under current Board guidelines, projects must meet a minimum profitability index of 0.8, and each company's annual investment portfolio must meet a minimum index of 1.1. Marginal projects that fall below a 0.8 profitability index due to new fees would not proceed. Even planned projects that exceed a 0.8 profitability index would be jeopardized because new municipal fees would reduce the net present value of the entire investment portfolio.

18. Moreover, Ontario municipalities are already adequately compensated for costs that arise from natural gas distribution. Based on the most recent estimates, the Gas Companies pay more than $71 million a year in property taxes on land, buildings, and underground pipes. Natural gas pipelines are buried and require little or no municipal attention, but still generate large tax payments to the local municipalities.

19. Municipal taxes paid by the Gas Companies far exceed the costs incurred by the municipalities as a result of the Gas Companies' presence. Unlike most businesses resident within a municipality, the Gas Companies do not benefit from many of the services for which taxes are levied. Buried pipelines do not benefit directly from

services such as garbage pick-up, recreational services, and transit. Any potential costs related to gas operations are more than covered by the significant dollars paid to municipalities in the form of property taxes on underground pipelines.

20. AMO has relied on s. 220(1) of the *Municipal Act* to support their position on permit fees, however, the Gas Companies maintain their position that they are exempted from these fees under section 220.1(4)(e) of the *Municipal Act.* This section specifically exempts any activities related to the transportation of natural resources.

21. The Gas Companies submit that permit fees imposed on gas utilities by municipalities attempting to increase their revenues would result in very substantial additional costs to natural gas ratepayers.

22. In summary, current provisions within the Model Franchise Agreement that prohibit municipal fees on gas distribution are consistent with ongoing legislative and regulatory reforms. Conversely, allowing new municipal fees would undermine the key reform objectives of low cost energy, level playing field, and customer choice. New municipal fees are also unwarranted, given the large sums of property taxes the Gas Companies already pay to Ontario municipalities each year.

Duration of New and Renewal Franchise Agreements

23. Section II(3) of the current Model Franchise Agreement establishes a twenty-year term for a first franchise agreement. It also states that any subsequent agreement shall be for a term of not more than fifteen years, unless the parties agree to extend it to twenty years at a maximum. It is common practice to renew franchise agreements for terms of either fifteen years or twenty years.

24. The franchise term is critical to the development and expansion of natural gas infrastructure across Ontario. Enbridge Consumers Gas, Union Gas, and Natural Resource Gas have made large investments in municipalities across Ontario. In each of the past four years, the Gas Companies have made combined annual investments that are in excess of $600 million. A long franchise term is necessary to protect these investments and to provide a secure climate for making future investments.

25. There is a standard time period over which the Gas Companies evaluate the economic feasibility of capital investments in the gas distribution system. Under the Board's feasibility guidelines for system expansion, investments to provide service to residential customers are generally evaluated over a period of forty years or more. These timelines coincide with the period over which the Gas Companies recover the return on an investment in the distribution system.

26. In particular, it generally takes up to forty years for the Gas Companies to achieve an internal rate of return that is equal to their Board-allowed investment hurdle rate

(weighted average cost of capital). Similarly, using the Board-allowed hurdle rate as a discount rate, the project achieves a net present value of zero, only as it approaches its forty-year mark. In the early years of the project, there are generally negative internal rates of return and negative net present values.

27. For these reasons, the standard franchise renewal duration is already deficient in the protection it provides for Gas Company investments. The term of most franchises is only approximately one-half the duration required to earn a fair return on new investments. Therefore, there is greater justification for an increase in the standard franchise term, than for a decrease in its term.

28. The arguments for a long franchise term apply to renewal agreements just as they apply to new agreements. The bulk of the Gas Companies' new investments are being made in municipalities where the franchise has already been renewed one or two times. These investments require the same protection under a sufficiently lengthy franchise, as do investments made in municipalities under an initial franchise.

29. A reduction in the standard franchise renewal duration would increase the Gas Companies' investment risk and reduce the feasibility of expansion projects. As a result, certain communities, their residents, and their businesses, could be left without the opportunity to choose natural gas over other forms of energy. Increased investment risk would also increase required rates of return and therefore increase natural gas rates for customers.

Insurance and Liability

30. Section III(5) of the Model Franchise Agreement currently indemnifies the municipality from claims arising from the Gas Companies' operations, construction, and maintenance. The indemnification does not apply in situations where damages arise from the negligence of the municipality or its employees. AMO has proposed that municipalities be added as an additional named insured under the Gas Companies' insurance policies, and that specific new limits of liability and administrative requirements be prescribed within the Model Franchise Agreement.

31. The Gas Companies believe that the current wording of the Model Franchise Agreement Section III (5) is adequate and clearly protects the municipality from claims resulting from the negligence of the Gas Companies. The Gas Companies maintain insurance coverage that is adequate to fulfill these terms. New administrative requirements and specific limits of liability would unnecessarily increase administrative costs for the Gas Companies and for natural gas customers.

32. AMO's proposal to have each municipality named on the Gas Companies' insurance policy is an unreasonable request and would place unreasonable

responsibility on the Gas Companies for municipal or third-party negligence. It should be expected that municipalities are liable for the negligence or wrongful act of its own servants, agents, or employees as are the Gas Companies.

33. The named insured is typically the person or entity that purchases a policy to cover instances where they might be found to be negligent, to protect their financial well being against an insurable type of event.

34. By seeking that municipalities be named on the Gas Companies' insurance policy, AMO is asking the Gas Companies to take insurance out on all municipalities. The Gas Companies' policies cannot and should not respond to municipally-caused negligence. Municipalities should be expected to maintain adequate insurance to cover instances where they might be found to be negligent.

35. The Gas Companies would, however, be prepared to insert a clause into the Model Franchise Agreement that indicates the municipality is an *additional* insured by virtue of having signed a franchise agreement. At present, the Gas Companies' policy responds first in the event of negligence caused by the Gas Companies. Being an additional insured will provide municipalities with further certainty that the Gas Companies' insurance policy would respond first in the event of any possible negligence on the part of the Gas Companies.

36. It is also important to note that insurance companies will not cover other parties for their negligence under a policy. In fact, The Gas Companies' insurance providers have advised that they would not permit the Gas Companies to name the municipalities to their insurance policies.

Geodetic Information & As Built Drawings

37. Section III(1) of the current Model Franchise Agreement states that geodetic information will not be required other than in certain limited circumstances. Geodetic information is only required in complex urban intersections in order to facilitate "known projects". AMO has proposed that there be a broader requirement to provide geodetic information, at the discretion of the municipal engineer.

38. The Gas Companies develop and utilize Geographical Information Systems (GIS) systems, along with other private and municipally-owned utilities. GIS systems are an important and effective tool for understanding the general location of utilities, and for determining whether a utility is present at a particular location within the roadway.

39. Geodetic information is different from GIS information. Geodetic information is very precise information on the exact location of an underground utility relative to a fixed point. It is more precise than GIS information, which provides a general electronic map of the pipeline relative to other utilities and the road allowance.

40. Geodetic information, on the other hand, is not widely used and, except in rare situations, does not exist for the private utilities or the municipal utilities.[1] It would be discriminatory to require the Gas Companies to provide geodetic information, when the same information is not required for other private and municipal utilities.

41. Moreover, geodetic information would provide questionable additional benefit over information contained in a GIS. This is because safety considerations dictate that physical locates must be conducted prior to working in close proximity to gas pipes. Even geodetic information does not alleviate the necessity set out in the *Energy Act* to conduct a physical locate prior to excavation.

42. The provision of geodetic information at the discretion of the municipal engineer would be very costly. In the rare instances for which geodetics are required, surveying services are contracted out at approximately $95 per hour. A surveyor will reference approximately 300 meters of pipeline per day. Together the Gas Companies lay approximately 2,000 kilometers of new gas main each year. Based on these figures, if geodetic referencing became common practice, the additional annual cost to the Gas Companies and to gas ratepayers would be in the range of $5 million.

43. The limited requirement for geodetics contained in the current Model Franchise Agreement is valid and strikes an appropriate balance between the needs of municipalities and the costs incurred by the companies and its customers. Any further requirement for geodetics could significantly increase the cost of gas distribution and add questionable benefit.

No Warranty As To Condition of Highway

44. Section III(1) of the Model Franchise Agreement establishes the requirement for municipal approval prior to gas system construction. The timing, terms and conditions relating to the installation of works must meet the approval of the municipality. AMO has proposed that wording be added to the effect that municipal approval for works is not a representation as to the state of the highway, or the presence or absence of hazardous substances.

45. The Gas Companies find it difficult to conceive of circumstances in which the approval of the Road Engineer as to the location of works would be tantamount to a representation and warranty as to the absence of hazardous materials beneath or in the vicinity of the highway, or as to the suitability of the highway for gas distribution purposes. However, the Gas Companies do not believe that this is an argument for amending the current Model Franchise Agreement in the manner proposed by AMO.

[1] Sewer utilities are an exception to this rule. Specific information on elevation is required for drainage purposes.

46. There may be rare situations in which the municipality has actual knowledge of hazardous materials on or under the highway. The Gas Companies do not want to lose the ability to rely on this knowledge if they suffer damages or are exposed to damage claims by third parties. Likewise, the Gas Companies are concerned that a contractual commitment to use municipal highways at their own risk could disentitle them to cite the negligence of the municipality as a legal cause of action or defense in appropriate circumstances.

47. The Gas Companies' position in this respect is nothing more than the recognition of the parties' relative positions at common law. The Gas Companies believe it to be unreasonable to require them to contract out of the common law in matters that are so heavily driven by specific factual circumstances, as is the case with environmental claims and damages.

48. Similarly, the absence of an acknowledgment that the Gas Companies use municipal highways at their own risk, does not add to the Gas Companies' rights, nor does it increase municipalities' liability exposure. It merely endorses the fact that the parties' respective positions should not be pre-judged by generalized contract language but should be dealt with in light of common law duties and specific circumstances.

Legislative Change Effects

49. The Model Franchise Agreement is a contract between the municipality and the Gas Company. Like any contract, the franchise terms and conditions apply to both parties for a known period of time established at the outset of a new franchise or franchise renewal. AMO has proposed that franchise agreements-in-process be reopened for possible amendment in response to legislative and/or regulatory changes.

50. Allowing legislative and regulatory changes to impact on franchises-in-process would increase the risk of existing and new gas infrastructure investments. Ongoing legislative changes may result in franchise amendments that have the effect of increasing capital and operating costs. They may also threaten the ownership structure or operating control over the gas distribution system. With new uncertainty, an additional risk premium would appropriately be added to the Gas Companies' return on investment, and to the discount rate utilized in feasibility calculations. This risk premium would place upward pressure on gas rates and reduce the amount of gas system expansion.

51. In addition, significant new administrative costs for the Board and the Gas Companies could arise from AMO's legislative change proposals. The Board would likely have to arbitrate over proposed changes to the Model Franchise Agreement for which there was no agreement between the Gas Companies and AMO. In effect, the Board may be put in the position of arbitrating over the Model Franchise Agreement on an ongoing basis.

52. Section IV(1) of the Model Franchise Agreement already provides municipalities with sufficient authority to implement the effect of provincial legislation. In particular, municipalities may impose by-laws of general application (except permit fee by-laws) on the Gas Companies. If the province amends the *Municipal Act* or other statutes to provide municipalities with new powers, municipalities can implement these through new by-laws, as long as they do not contradict the terms of the Model Franchise Agreement.

53. However, allowing a Model Franchise Agreement to be amended mid-term, in response to ongoing legislative and regulatory change, would have an adverse impact on rates and expansion.

Default Provisions

54. The Gas Companies deliver natural gas to consumers in municipalities under franchise agreements. The Ontario Energy Board must approve all franchise agreements with municipalities before they come into effect.

55. The Gas Companies do not believe that it is in the public interest to subject the Model Franchise Agreement to potential termination each time the municipality claims the company is in default of any provisions within the agreement. An opportunity for municipalities to terminate the franchise agreement at their discretion would create uncertainty for the utility and also for natural gas ratepayers, thereby placing upward pressure on rates and inhibiting further investment and system expansion.

56. As a result of this tripartite agreement, and the Board's regulatory role, municipalities have the ability to approach the Board at any time with concerns they may have regarding the operations and conduct of the Gas Companies. If certain municipalities feel that the Gas Companies are not living up to their obligations as outlined in this agreement, they can bring these concerns to the Board and have them addressed accordingly.

57. The Gas Companies also note that there are effective local forums for addressing potential issues that arise between all utilities and the municipality. Through Public Utility Coordinating Committees (PUCCs), the Gas Companies and other utilities jointly plan operations and ensure that potential conflicts are addressed to the satisfaction of all parties. The Gas Companies have a long history of successfully cooperating with municipalities through the PUCCs.

Abandoned Gas Pipe

58. Section IV(3) of the Model Franchise Agreement states that the Gas Companies need only remove abandoned gas pipe from the ground at their discretion. Municipalities can remove abandoned gas pipe in the ground to facilitate the construction of municipal works. AMO has proposed that municipalities be given the right to remove abandoned gas pipes in the ground, whether to facilitate construction or not, at the expense of the Gas Company.

59. There are no safety considerations surrounding AMO's proposals for the removal of abandoned gas pipe. Section IV(3) of the current Model Franchise Agreement provides for proper deactivation of abandoned gas pipe. The Gas Companies deactivate abandoned gas pipe in keeping with technical codes. This deactivation process ensures that abandoned pipes are safe, and that they will not cause any accidents within the municipality.

60. In the absence of any safety considerations, it would be wasteful and very costly to remove all abandoned gas pipe in the ground. Removing gas pipe in the process of construction in the roadway is sensible and inexpensive. The removal can be carried out as part of the broader construction and excavation activities. However, the removal of abandoned gas pipe outside the context of broader construction activities within the roadway would be unnecessary, potentially more intrusive than the original installation, costly, and will place upward pressure on gas rates.

61. It would also be inappropriate to forfeit ownership of abandoned gas pipe to the municipality in which it is located. Investments in gas pipes are made by the Gas Companies for the benefit of gas ratepayers across the entire gas system. If abandoned pipes can generate any future revenues, in the use as a telecommunications conduit or in some other use, Gas Company ratepayers should have the opportunity to benefit from this revenue stream. Any value remaining in abandoned gas pipes should not automatically be transferred to municipalities.

62. However, municipalities would also have an opportunity to benefit financially from the use of abandoned gas pipe as a conduit. AMO and the Gas Companies agreed that a Municipal Access Agreement would be required by any third party utilizing a decommissioned gas pipe for purposes other than the transmission and distribution of natural gas.[2] Under this Access Agreement, the municipality may levy fees on the third party occupant.

Conclusions

63. The Model Franchise Agreement has served Ontario well since it was introduced in 1987. The principles of ensuring a low-cost supply of energy, expanding choice for

[2] See Section A-1(10) of the "Summary of Discussions" document submitted to the OEB on September 24, 1999.

energy customers, and maintaining a level playing-field between gas and electricity, should guide any reform to the Model Franchise Agreement.

64. Based on these principles, certain amendments are timely and appropriate at this time to update the Agreement and to ensure that it continues to facilitate the provision of low cost natural gas to as many Ontarians as possible. These amendments are contained in Section A-1 of the “Summary of Discussions” document submitted to the Board on September 24, 1999.

65. Other amendments proposed by AMO are not appropriate. The evidence suggests that amendments such as allowing new municipal fees, reducing the term of franchise agreements, and expanding the requirement for geodetic information, would raise gas rates, reduce gas system expansion, and negatively impact on gas distributors relative to electricity distributors. AMO’s proposals in this regard are inconsistent with provincial policy and the new regulatory framework for energy in Ontario.