



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

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## DECISION AND ORDER

EB-2017-0306 AND EB-2017-0307

## UNION GAS LIMITED AND ENBRIDGE GAS DISTRIBUTION INC.

Enbridge Gas Distribution Inc. and Union Gas Limited Application for  
Amalgamation and Rate-Setting Mechanism

**BEFORE:** Lynne Anderson  
Presiding Member

Christine Long  
Vice-Chair and Member

Cathy Spoel  
Member

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August 30, 2018

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# 1 INTRODUCTION AND SUMMARY OF FINDINGS

Enbridge Gas Distribution Inc. (Enbridge Gas) and Union Gas Limited (Union Gas), jointly referred to as the applicants, filed an application dated November 2, 2017 with the Ontario Energy Board (OEB) under section 43(1) of the *Ontario Energy Board Act, 1998* (the Act), for approval to effect the amalgamation of Enbridge Gas and Union Gas into a single company referred to as Amalco. On November 23, 2017, the applicants filed another application with the OEB under section 36 of the Act for approval of a rate setting mechanism for the proposed Amalco, effective January 1, 2019.

Enbridge Gas is a rate-regulated gas distribution, storage and transmission company serving over 2.1 million residential, commercial and industrial customers in 121 franchise areas of central and eastern Ontario, including the Greater Toronto Area (GTA), the Niagara Peninsula, Ottawa, Brockville, Peterborough and Barrie. Its head office is in the City of Toronto and it has approximately 2,100 employees. Enbridge Gas currently operates under a five-year Custom Incentive Rate-setting (IR) framework approved by the OEB and ending in 2018.<sup>1</sup>

Union Gas is a rate-regulated natural gas storage, transmission and distribution company serving about 1.5 million residential, commercial and industrial customers in over 400 communities across northern, southwestern and eastern Ontario. Its head office is in the Municipality of Chatham-Kent and it has approximately 2,300 employees. Union Gas currently operates under a five-year price cap Incentive Rate-setting Mechanism (IRM) approved by the OEB and ending in 2018.<sup>2</sup>

The applicants have been under common ownership since February 27, 2017 when Enbridge Gas' corporate parent, Enbridge Inc., merged with Union Gas' corporate parent, Spectra Energy Corp. Both companies (Enbridge Gas and Union Gas) were expected to file rebasing applications for 2019 rates. However, the companies have proposed to merge and defer rebasing until 2029.

The applicants prepared their applications on the basis of the OEB's Handbook to Electricity Distributor and Transmitter Consolidations (MAADs Handbook), which provides guidance on applications for mergers, acquisitions, amalgamations and divestitures (MAADs). Accordingly, the applicants proposed a deferred rebasing period

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<sup>1</sup> EB-2012-0459

<sup>2</sup> EB-2013-0202

of ten years and a rate-setting framework based on the Price Cap Incentive rate-setting (Price Cap IR) option.<sup>3</sup>

The applicants proposed an issues list that was based on their position that the OEB's MAADs policy framework applied in its entirety to these applications. The intervenors filed an alternative issues list that framed the issues on the basis that the application of specific aspects of the MAADs policy was a matter for argument, and that the MAADs policy did not necessarily apply in its entirety to this transaction.

The OEB heard written submissions on the issues list. OEB staff and intervenors argued that not all elements of the MAADs Handbook applied to the gas distributors, as the policy was adopted to incent consolidation within the electricity sector in Ontario. The OEB's decision on the issues list<sup>4</sup> accepted the intervenors' and OEB staff's argument. The OEB found that there is no reference to the gas distributors in the MAADs Handbook and that parties would not be restricted from questioning the applicability of the policies to this transaction. The OEB also decided that it would apply the "no harm" test to assess the proposed amalgamation.

The OEB also decided to combine the amalgamation and rate-setting framework applications as they were inter-related, and doing so would lead to procedural efficiencies.

For reasons that follow, the OEB has made the following key determinations:

1. The request for amalgamation meets the "no harm" test. The OEB grants leave to the applicants to amalgamate Enbridge Gas and Union Gas under section 43(1) of the *Ontario Energy Board Act, 1998*, into a single company, subject to the conditions set out herein.
2. The OEB approves a deferred rebasing period of five years.
3. The OEB approves an annual rate change during the deferred rebasing period based on a price cap index (PCI), where PCI growth is driven by an inflation factor using GDP IPI FDD, less a productivity factor of zero and a stretch factor of 0.3%.
4. The OEB approves an asymmetrical earnings sharing mechanism during the deferred rebasing period that will be implemented from year one and share

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<sup>3</sup> Handbook to Electricity Distributor and Transmitter Consolidations, January 19, 2016, page 12 – consolidating distributor can chose a deferred rebasing period of 10 years with no supporting evidence.

<sup>4</sup> Decision and Procedural Order No. 3, March 1, 2018.

earnings on a 50/50 basis between the applicants and ratepayers for all earnings in excess of 150 basis points over the OEB-approved return on equity.

5. The OEB approves the use of an Incremental Capital Module during the deferred rebasing period, the details of which are outlined in Section 5.5.
6. The OEB accepts the use of the proposed Y factors, with the exception of the Cap-and-Trade costs to be addressed in a separate proceeding; additional direction has been provided on the proposed Normalized Average Consumption/Average Use true up.
7. The Z-factor materiality threshold will be set at \$5.5 million on a revenue requirement basis.
8. The OEB accepts the proposed base rate adjustments.
9. Amalco is required to file a cost allocation study in 2019 for the legacy Union Gas service area to take into account certain major capital projects.
10. During the deferred rebasing period, Amalco will continue to purchase market-based storage services to meet the needs of legacy Enbridge Gas in-franchise customers.

## 2 THE APPLICATION

The applicants filed two applications, one requesting the amalgamation and a deferred rebasing period of ten years<sup>5</sup> and the other requesting a ratemaking framework based on Price Cap IR.<sup>6</sup> As noted earlier, the OEB combined the two applications.

The applicants argued that the proposed amalgamation meets the “no harm” test and that the merger would have a positive effect on the attainment of the OEB’s statutory objectives. In financial terms, the applicants estimated the cumulative benefit to customers of amalgamation to be \$410 million over the deferred rebasing period. This benefit represents the difference between the costs of two utilities operating separately under a Custom IR for a period of two five-year terms (for a total of ten years) and an amalgamated utility.

The amalgamation involves a conversion of Enbridge Gas and Union Gas shares into shares of Amalco, with no change of control.

In line with the MAADs policy framework, the applicants proposed a ten year deferred rebasing period opting to rebase in 2029. The applicants submitted that a ten year deferred rebasing period was necessary to allow Amalco to integrate and have sufficient time to make the capital and system investments necessary to generate integration synergies across the combined Enbridge Gas and Union Gas operations.

In a second application, the applicants requested a rate setting mechanism for the period 2019 to 2028 with the following parameters:

- 1 An annual rate change calculation using a price cap index (PCI), where PCI growth is driven by an inflation factor, less a productivity factor of zero, and no stretch factor.
- 2 The duration of the rate-setting mechanism would be ten years (the deferred rebasing period).
- 3 The framework would continue to pass-through routine gas commodity and upstream transportation costs, demand side management cost changes, lost revenue adjustment mechanism changes for the contract market, normalized average consumption/average use, and Cap-and-Trade costs.
- 4 The ability to address material changes in costs associated with unforeseen events outside of the control of management (Z-factor). The applicants initially proposed a

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<sup>5</sup> EB-2017-0306.

<sup>6</sup> EB-2017-0307.

materiality threshold of \$1.0 million, consistent with the threshold for electricity distributors, but proposed a revised materiality threshold of \$5.5 million in their reply submission.

The applicants also applied for the following approvals:

1. Recovery through rates for qualifying incremental capital investments through the OEB's Incremental Capital Module (ICM):
  - a. based on separate materiality threshold calculations using rate base and depreciation expense last approved by the OEB in 2013 rates for Union Gas and 2018 rates for Enbridge Gas; and
  - b. using incremental cost of capital to calculate the revenue requirement to fund incremental capital investment:
    - i. 64/36 debt to equity ratio;
    - ii. incremental cost of long-term debt issued; and
    - iii. allowed return on equity (ROE) based on OEB's cost of capital formula for the year the investment is placed in service.
2. An adjustment (increase) of \$17.4 million pre-tax (\$12.8 million after-tax) to Union's 2018 OEB-approved revenue reflecting the full amortization of the accumulated deferred tax balance at the end of 2018.
3. An adjustment (decrease) of \$4.9 million to Enbridge Gas' 2018 OEB-approved revenue reflecting the completion of the smoothing of costs related to Enbridge Gas' Customer Information System and customer care forecast costs.
4. The continuation of certain existing deferral and variance accounts and the discontinuation of others.
5. Recovery of \$6.5 million related to certain pension and Other Post-Employment Benefits (OPEB) costs associated with amendments to the *Pension Benefits Act* legislation that was not recovered in the Enbridge Gas 2018 rates proceeding.<sup>7</sup> This Bill has now received Royal Assent and the applicants are seeking recovery of this amount in 2019 rates.
6. For purposes of setting 2019 rates and beyond, the applicants proposed to remove \$11.2 million in tax deductions that are currently embedded in Enbridge Gas' 2018

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<sup>7</sup> EB-2017-0307.

revenue requirement because there is no longer any ongoing Site Restoration Costs (SRC) refund and therefore the associated tax deductions will no longer be available in years following 2018.

The following parties were approved as intervenors in the proceeding:

- Association of Power Producers of Ontario (APPrO)
- Building Owners and Managers Association Toronto (BOMA)
- Canadian Manufacturers and Exporters (CME)
- City of Kitchener (Kitchener)
- Consumers Council of Canada (CCC)
- Energy Probe Research Foundation (Energy Probe)
- Federation of Rental-housing Providers of Ontario (FRPO)
- Independent Electricity System Operator
- Industrial Gas Users Association (IGUA)
- Just Energy Ontario L.P.
- London Property Management Association (LPMA)
- Municipality of Chatham-Kent
- National Grid
- Ontario Association of Physical Plant Administrators (OAPPA)
- Ontario Greenhouse Vegetable Growers (OGVG)
- Ontario Petroleum Institute
- Ontario Power Generation Inc.
- Rover Pipeline LLC
- Six Nations Natural Gas Company Limited
- School Energy Coalition (SEC)
- TransCanada PipeLines Limited (TransCanada)
- Unifor
- Vulnerable Energy Consumers Coalition (VECC)



### 3 THE PROCESS

The OEB issued a Notice of Hearing on December 1, 2017 for both applications. In Procedural Order No. 1 issued on December 22, 2017, the OEB approved a list of intervenors and scheduled an Issues Conference, an Issues Day and a discovery process.

An Issues Conference was held on January 15, 2018 for the MAADs application and on January 22, 2018 for the rate-setting application, with the objective of developing a proposed issues list for presentation to the OEB. However, there was no consensus on the issues list proposed by the applicants. The parties did agree on the addition of three issues that were proposed by the Municipality of Chatham-Kent.

The OEB issued Procedural Order No. 2 on January 16<sup>8</sup> and January 23, 2018<sup>9</sup> cancelling the Issues Day for both proceedings and scheduled a written process for filing submissions on the draft issues list. The applicants filed their argument-in-chief on January 19 and 26, 2018 with respect to both issues lists.

Intervenors and OEB staff filed their submissions on the issue lists on January 26 (MAADs Application) and February 2, 2018 (Rate-setting Mechanism Application). In Decision and Procedural Order No. 3 issued on March 1, 2018, the OEB determined that the OEB's MAADs policy framework for electricity distributors would not apply in its entirety to these applications. The OEB also combined the two proceedings to make the process more efficient and provided a final Issues List for the combined proceeding. The OEB also provided for a written discovery process (interrogatories), a technical conference, filing of intervenor evidence and interrogatories on that evidence, and scheduled an oral hearing.

In Procedural Order No. 5, the OEB required that all parties who wished to cross-examine at the oral hearing file their initial positions on certain key matters in advance of the oral hearing.

An oral hearing was held in May 2018. The applicants filed their argument-in-chief on June 1, 2018 followed by final arguments of all parties on June 15, 2018 and the applicants' reply argument on June 29, 2018.

The OEB received eight letters of comment that expressed a range of concerns about the amalgamation including:

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<sup>8</sup> EB-2017-0306

<sup>9</sup> EB-2017-0307

- the effect on jobs and services
- rate increases and ensuring the savings and benefits flow to customers
- the length of the proposed deferred rebasing period
- the mechanism proposed for setting rates
- the location of the monitoring and control of the natural gas system

The OEB considered these comments as it assessed the applicants' proposals.

## 4 DECISION ON AMALGAMATION

### 4.1 No Harm Test

In Decision and Procedural Order No. 3, the OEB determined that it would apply the “no harm” test in this proceeding to determine if the applicants’ leave to amalgamate should be granted. In the assessment of consolidation transactions in the electricity sector, the OEB has consistently applied the “no harm” test since 2005.<sup>10</sup> The no harm test considers whether the proposed transaction will have an adverse effect on the attainment of the OEB’s statutory objectives. Where a proposed transaction is determined to have a positive or neutral effect on the attainment of these objectives, the OEB will approve the application. The OEB has applied the no harm test in assessing this application.

The OEB’s statutory objectives for the gas sector are set out in section 2 of the Act:

1. To facilitate competition in the sale of gas to users.
2. To protect the interests of consumers with respect to prices and the reliability and quality of gas service.
3. To facilitate rational expansion of transmission and distribution systems.
4. To facilitate rational development and safe operation of gas storage.
5. To promote energy conservation and energy efficiency in accordance with the policies of the Government of Ontario, including having regard to the consumer’s economic circumstances.
- 5.1 To facilitate the maintenance of a financially viable gas industry for the transmission, distribution and storage of gas.
6. To promote communication within the gas industry and the education of consumers.

Most of the intervenors and OEB staff suggested that the OEB should approve the amalgamation of Enbridge Gas and Union Gas under section 43 of the Act. IGUA submitted that utility shareholders should be free to structure their utility operations as they see fit, as long as ratepayer interests are not unduly compromised. CCC noted that the amalgamation will provide significant and sustainable benefits to current and future ratepayers in Ontario.<sup>11</sup> Kitchener did not take a position on this issue. Unifor, the union

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<sup>10</sup> Decision of the OEB in combined proceeding RP-2005-0018/EB-2005-0234/-0254/-0257, August 31, 2005.

<sup>11</sup> CCC Submission, page 2.

representing many of the employees at both Enbridge Gas and Union Gas, submitted that the OEB should dismiss the application absent the applicants providing financial forecasts containing verifiable information regarding ratepayer savings and the means to achieve them.

## **OEB Findings**

The OEB concludes that the amalgamation meets the no harm test. The OEB therefore grants leave to the applicants to amalgamate Enbridge Gas and Union Gas into a single company subject to the conditions set out herein.

In determining that the amalgamation meets the no harm test, the OEB has focused on the objectives that are of most direct relevance to the impact of the proposed transaction; namely, reliability and quality of gas service, financial viability and price.

### **4.2 Reliability and Quality of Gas Service**

The applicants have committed that Amalco will continue to maintain the safety, reliability and quality of service to Enbridge Gas and Union Gas customers, both in-franchise and ex-franchise. Amalco will continue to be subject to, and will report on, all existing Service Quality Requirements (SQRs) applicable to gas utilities. The applicants have also proposed a scorecard that will report on a variety of metrics.

None of the parties except Unifor argued that the reliability and quality of service will be adversely impacted as a result of the proposed amalgamation. Unifor observed that as the proposed amalgamation will require significant restructuring, the quality and reliability of service is likely to be affected during the transition. Unifor argued that the efficiencies proposed by the applicants will inevitably result in the elimination of staff and that the applicants had not provided a plan as to how they intend to maintain the reliability and quality of service in light of staffing reductions. Unifor therefore submitted that the no harm test had not been satisfied and the application should be dismissed.<sup>12</sup>

The applicants took the position that the proposed amalgamation meets the no harm test and that arguments to the contrary should be disregarded.

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<sup>12</sup> Unifor submission, pages 4-5.

## **OEB Findings**

The OEB is satisfied that the proposed transaction will not lead to any adverse impact with respect to the reliability and quality of service, and the OEB finds that the no harm test is met in this regard.

The OEB accepts the applicants' position that efficiencies can be gained without compromising the ability of Amalco to maintain current levels of reliability and quality of service. Furthermore, the new gas utility will be subject to the same requirements under the OEB's Gas Distribution Access Rules (GDAR).

### **4.3 Financial Viability**

The application notes that the proposed amalgamation is not expected to have an impact on the financial viability of Amalco as it is a conversion of Enbridge Gas and Union Gas shares into shares of Amalco, with no change of control.

None of the intervenors took issue with this position nor did any express concerns about the impact of this transaction on the financial viability of the gas industry in Ontario.

## **OEB Findings**

The OEB finds that the proposed sale transaction meets the no harm test with respect to financial viability of the gas industry.

### **4.4 Price**

With respect to price, the applicants claimed that the proposed amalgamation will provide greater benefits to customers than continued stand-alone operations of Enbridge Gas and Union Gas. Their comparison of the status quo, that is the annual revenue requirement of Enbridge Gas and Union Gas operating individually under Custom IR during the ten-year proposed deferred rebasing period, to the revenue of Amalco operating as an amalgamated entity under Price Cap IR, showed a cumulative benefit of \$410 million over the deferred rebasing period.

This claim was disputed by a number of intervenors who argued that the claimed benefit has not been substantiated and is not credible. SEC argued that the \$410 million benefit is an illusion because the applicants' "straw man" calculation is dramatically

overstated.<sup>13</sup> SEC argued that the applicants did not provide details such as capital continuity tables and year-by-year OM&A budgets to substantiate their claim. Despite this, SEC observed that the “no harm” test with respect to amalgamation had been met, as it does not require the demonstration of benefits. However, SEC argued that the applicants’ rate setting proposal and rebasing period were not just and reasonable.

In reply, the applicants said that it was not possible to file detailed evidence of the impacts of the stand-alone scenario in the amalgamation application. However, the applicants argued that they had developed a reasonable basis for comparison. In support of their position, the applicants relied on the OEB’s decision in the Alectra proceeding,<sup>14</sup> in which the OEB found that the cost estimates provided by the consolidating entities were a sufficiently accurate basis for its analysis.<sup>15</sup>

Other intervenors such as VECC, APPrO, CME, OGVG, LPMA and IGUA submitted that apart from the rate proposal and deferred rebasing period, the applicants had met the no harm test.

In general, the intervenors and OEB staff agreed that the merger of the two utilities will increase productivity and benefit ratepayers in the long-term. Unifor was the only exception. Unifor submitted that the applicants had not demonstrated that the costs to serve acquired customers would be no higher than they otherwise would have been.<sup>16</sup> Accordingly, Unifor claimed that the applicants failed to meet the no harm test.

## **OEB Findings**

The OEB finds that the proposed amalgamation meets the no harm test in relation to price given the rate framework approved by the OEB in this Decision. The OEB is satisfied that the amalgamation will result in underlying costs of service that are no greater than they would have been for the separate companies.

## **4.5 Conditions of Approval**

### Agreement with Chatham-Kent

Under the Undertakings provided by Union Gas and related parties to the Lieutenant Governor in Council (Union Undertakings), which took effect in 1999, Union Gas is

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<sup>13</sup> SEC submission page 21, 2.4.21.

<sup>14</sup> Decision and Order, EB-2016-0025/EB-2016-0360, page 12.

<sup>15</sup> Applicants Reply, page 13, paras 37 and 38.

<sup>16</sup> Unifor submission, page 2.

required to maintain its head office in the Municipality of Chatham-Kent (Chatham-Kent or the Municipality). The parties to the Union Undertakings are released from the requirements upon the amalgamation of Union Gas and Enbridge Gas because Westcoast Energy will no longer hold more than 50% of voting securities in Union Gas.

The applicants made four commitments to Chatham-Kent in a March 7, 2018 letter with respect to their presence in the Municipality. The applicants propose that those commitments be adopted by the OEB as conditions of approval for the amalgamation as follows:

1. Amalco shall ensure that during the deferred rebasing period any employment impacts resulting from the amalgamation will be managed on a roughly proportionate basis between the Municipality of Chatham-Kent and the City of Toronto;
2. To the extent that Centres of Excellence are created in either the Municipality of Chatham-Kent or the City of Toronto, the Centres of Excellence shall reflect a range of skills and compensation levels, including leadership roles;
3. Employment within the Municipality of Chatham-Kent shall reflect a mixture of entry, middle and senior level roles; and
4. Amalco will commit to a process of regular communication and engagement with the Municipality of Chatham-Kent in respect of the amalgamation and its related impacts and opportunities.

The Municipality says these conditions are critical to the economic health of Chatham-Kent, which has suffered significant job losses as a result of, among other things, the erosion of its manufacturing sector. According to the Municipality, Union Gas is the largest private sector employer in Chatham-Kent. The Municipality submitted that the conditions would continue a decades-old commitment on the part of the government, the OEB and the owners of Union Gas to protect the interests of Chatham-Kent. Chatham-Kent was of the opinion that the OEB has the authority to continue that commitment.

In its submission, OEB staff explained that although the OEB has the jurisdiction to include the conditions jointly requested by the applicants and the Municipality, OEB staff had some concerns about doing so, namely: (1) the conditions are not necessary, as the evidence suggests that the applicants will maintain a significant presence in the Municipality despite the lapsing of the Union Undertakings; (2) the conditions might even be seen as frustrating the Government of Ontario's policy intent, as it was the Government that agreed to the expiry clause in the Union Undertakings; and (3) the OEB is above all an economic regulator, and might one day, if Amalco applied to reduce

its presence in the Municipality, find itself having to arbitrate a situation which may require the weighing of interests that are outside its core expertise.

Aside from the Municipality, the only intervenor to make submissions on this issue was LPMA, who expressed the general concern that any conditions that may be attached to the OEB's approval of the merger might lead to higher costs and/or lower savings.

In their reply submission, the applicants supported Chatham-Kent's submission, and added that, in light of the OEB's historical role as overseer of the Union Undertakings, it would be appropriate for the OEB to fill the gap that will be created upon the expiry of the Union Undertakings by approving the requested conditions.

### **OEB Findings**

The OEB approves the proposed conditions of approval during the deferred rebasing period to provide a period of transition following the release of Union Gas from the provisions of the Union Undertakings.

Section 4.1 of the current Union Undertakings states that "The head office of Union shall remain in the Municipality of Chatham-Kent". The parties to the Union Undertakings would be released from this requirement following the amalgamation. The applicants made four commitments to Chatham-Kent in their March 7, 2018 letter with regard to the presence that Amalco will maintain in Chatham-Kent in the event that the amalgamation is approved. The OEB agrees that the commitments made by the applicants are reasonable and will not lead to unreasonable costs to Amalco during the deferred rebasing period.

In its Argument in Chief, the applicants stated that a transition is appropriate rather than an abrupt end to the provisions of the Union Undertakings. The OEB agrees that it is appropriate to have the conditions of approval in place during the deferred rebasing period to provide this period of transition. While only the first of the four proposed conditions referred to the deferred rebasing period, the OEB finds it appropriate to have the same transition period for all of the conditions.

The OEB has the authority to impose such conditions as it considers proper.<sup>17</sup> Conditions 1) and 3) above are reasonably consistent with the intent of the Union Undertaking and therefore are appropriate during the deferred rebasing period. While condition 2) related to Centres of Excellence may appear to be broader in scope, the OEB notes that it does not require Amalco to establish such Centres of Excellence.

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<sup>17</sup> Section 23 of the Act.



Condition 4) commits Amalco to regular communication and engagement with Chatham-Kent. The OEB expects Amalco to maintain strong stakeholder relations with all of its stakeholders, therefore, this condition is reasonable.

## 5 DECISION ON RATE FRAMEWORK

Section 2 outlines the rate framework that the applicants proposed in their application. This proposal includes a Price Cap IR that adjusts rates on an annual basis using an inflation factor, a productivity factor of zero and no stretch factor. The proposed duration of the rate-setting mechanism is ten years.

The proposed framework includes Y factors to pass through routine gas commodity and upstream transportation costs, demand side management cost changes, lost revenue adjustment mechanism changes for the contract market, normalized average consumption/average use, and Cap-and-Trade costs.

The applicants also proposed a Z-factor to recover costs related to unforeseen events outside of the control of management. The application sought a materiality threshold of \$1.0 million. In its reply argument, the applicants revised the requested materiality threshold to \$5.5 million.

The applicants also applied to recover qualifying capital investments through the OEB's Incremental Capital Module (ICM) methodology, and for certain base rate adjustments for 2019 rates.

### 5.1 Rate Framework Policies

In preparing their application, the applicants followed the MAADs Handbook. The applicants' view was that the MAADs Handbook applied to gas distributors and transmitters as well as to electricity distributors and transmitters. Many other parties disagreed, arguing that the MAADs Handbook only applied to the electricity sector, and that different considerations and policies were appropriate in the gas context.

The OEB heard submissions on this issue and issued a decision with Procedural Order No. 3. The OEB determined that, although it provided useful guidance, the policies of the MAADs Handbook did not automatically apply to the gas sector:

The OEB does not agree with the arguments of the applicants and accepts the position of intervenors and OEB staff that all aspects of the MAADs Handbook do not automatically apply to natural gas. The MAADs Handbook does not specifically reference natural gas and there is no specific guidance in the Handbook as to how gas mergers should proceed. The OEB is of the view that issues such as the deferral period and earnings sharing mechanism are legitimate areas of inquiry and are not

predetermined in this case. The OEB may find that the MAADs Handbook applies in part or in whole, but this does not preclude parties from arguing for or against the applicability of specific elements of the MAADs Handbook, with the exception of the applicability of the no harm test.<sup>18</sup>

In light of this decision, the applicants argued that this application was consistent with the overall policies of the OEB, and that in particular the policies of the MAADs Handbook were appropriate for this application.<sup>19</sup> Other parties disagreed.

## OEB Findings

The MAADs Handbook was developed for the consolidation of electricity distributors and transmitters, with the focus on electricity distributors. The policies were developed to incent the consolidation of electricity distributors. At the time the MAADs Handbook was issued, there were more than 70 electricity distributors and only three gas distributors.

The OEB agrees that the principles and objectives established in the Renewed Regulatory Framework (RRF)<sup>20</sup> apply to all utilities, e.g. an outcomes based approach, but there are many ways that these outcomes can be achieved without an amalgamation. As noted in Decision and Procedural Order No. 3, the OEB's MAADs policies do not automatically apply to the gas utilities. They must be tested to ensure that they are reasonable given the different circumstances of the gas utilities.

The OEB finds that it is appropriate to allow the applicants to defer rebasing for five years and to adopt a Price Cap IR rate-setting mechanism during this deferred period. Price Cap IR is a well-established mechanism for the OEB, and Union Gas has been on a version of this mechanism since 2014. Details of the approved rate-setting framework are discussed in the following sections.

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<sup>18</sup> Decision and Procedural Order No. 3, March 1, 2018, p. 6.

<sup>19</sup> See, for example, the applicants' reply argument, pp. 3-9.

<sup>20</sup> Report of the Board - Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach, page 11, October 18, 2012 and Handbook for Utility Rate Applications, October 13, 2016.

## 5.2 Deferred Rebasing Period

The applicants proposed a deferred rebasing period of ten years. In support of their request, the applicants referred to the MAADs Handbook which allows consolidating distributors to select a maximum deferral period of ten years with no supporting evidence to justify the selected deferral period. The applicants maintain that a ten-year deferred rebasing period is necessary to undertake a large and complex integration and to deliver significant integration savings and synergies to ratepayers on rebasing.

With the exception of the Municipality of Chatham-Kent, none of the other parties supported a ten-year deferred rebasing period. The Municipality of Chatham-Kent noted that the rebasing period was necessary to allow the area of Chatham-Kent to adjust to any loss of employment as a result of the amalgamation.

A number of intervenors and OEB staff raised issues related to a long deferral period. These included that:

- A full examination of the two utilities' costs was last undertaken in 2012 and 2013. Decoupling revenues from costs for 15 years is not appropriate and contrary to good regulatory practice.
- The election of the ten-year deferred rebasing period in the MAADs Handbook was intended to promote consolidation in the electricity sector in Ontario and to allow consolidating utilities to recover transaction and integration costs. There was no mention of natural gas in the MAADs Handbook, and as there are only three natural gas utilities in the Province, there was no need to incent consolidation in the natural gas sector.

SEC argued that the applicants' claim that they needed time to complete integration and realize savings was not supported by the evidence, and there is therefore no rationale for a ten year deferred rebasing period. SEC noted that the total cost of consolidation is expected to be \$150 million, and in the first year, the costs exceed the achieved savings by \$8 million as per the applicants' evidence.<sup>21</sup> By the end of 2020, the costs are expected to exceed the shortfall by only \$4 million, after which point the cumulative savings exceed the costs for the duration of the deferred rebasing period. SEC further noted that this calculation excluded the \$5.2 million in annual savings already achieved by the end of 2017 as a result of combining certain activities of Enbridge Gas and Union Gas.<sup>22</sup> SEC further noted that the consolidation does not involve substantial transaction costs, as they are both already owned by the same parent company.

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<sup>21</sup> EB-2017-0306, Exhibit B, Tab 1, Attachment 12.

<sup>22</sup> Transcript Volume 1, pages 67-68.

SEC also disagreed that it was appropriate for the applicants to deduct \$410 million in stated benefits from the savings calculation in order to earn the allowed ROE. This approach pushes the net benefits to Amalco until the later years (at year eight of the ten-year deferred rebasing period). SEC argued that this approach is based on the assumption that the expected savings of \$680 million as a result of the amalgamation over the ten-year period and the standalone assumptions used to calculate the \$410 million ratepayer benefit are reasonable. SEC submitted that neither of these assertions is credible.<sup>23</sup> A number of other intervenors (APPrO, FRPO, CCC, LPMA and CME) agreed with SEC.

Intervenors and OEB staff also raised concerns about cost allocation and the true-up of average consumption. They submitted that there are existing inequities with respect to the allocation of costs that need to be corrected. Although Union Gas has agreed to review costs allocated to the Panhandle Reinforcement project, intervenors and OEB staff argued that to make selected adjustments for certain assets now while leaving other adjustments until 2029 would not be fair to the overall customer base. Energy Probe argued that the lengthy period between rebasing and the many cost allocation issues will create rates that would no longer be considered just and reasonable.<sup>24</sup> In reply argument, the applicants proposed to prepare cost allocation studies for each of the years 2022 and 2026 using OEB-approved methodologies, and indicated their willingness to consider changes to cost allocation with the expectation that there would be no impact on the revenue requirement.

The City of Kitchener (Kitchener) noted that its transportation demand charge has increased by 92% over a five-year period. If a ten-year deferred rebasing period was approved, Kitchener would not be able to resolve its cost allocation issues, and the significant rate increases associated with some recent large infrastructure projects of Union Gas would be included in Kitchener's rates for a further ten years.

OEB staff noted that the average use model for Enbridge Gas had a structural break in 2016 and such issues would only be examined at rebasing, and that a ten-year deferred rebasing period was therefore not appropriate.

As a result, a number of intervenors requested immediate rebasing (SEC, FRPO, CCC, LPMA, IGUA, Energy Probe, Kitchener, BOMA and APPrO) and argued that the OEB should require Amalco to file a rebasing application for 2021 rates. They suggested that in the meantime, the two utilities could continue with their respective IR plans or Enbridge Gas could adopt the Price Cap IR of Union Gas.

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<sup>23</sup> SEC submission, pages 20-21.

<sup>24</sup> Energy Probe submission, page 3.

In support of immediate rebasing, several intervenors cited the Settlement Agreement in Union Gas' IRM Framework Application<sup>25</sup> which required Union Gas to file a cost-of-service filing in 2019 regardless of whether Union Gas applies to set rates for 2019 on a cost-of-service basis.

Intervenors noted that Enbridge Gas made an equivalent commitment in the oral hearing of its Custom IR application.<sup>26</sup> Intervenors (SEC, IGUA, APPrO and Kitchener) submitted that the utilities should not be allowed to renege on those commitments. The applicants disagreed with this interpretation of the Settlement Agreement and argued that it does not state when Union Gas will rebase but what Union Gas will do when it does rebase. The applicants argued that until the OEB has determined when rebasing will occur, it is not possible to conclude that Union Gas' agreement to prepare a full cost of service had been triggered. The applicants also argued that Enbridge Gas' evidence in its proceeding was given in the context of the Union Gas Settlement Agreement and was based on the expectation that the two utilities would continue to operate individually rather than in the context of a proposed amalgamation.<sup>27</sup>

In response to the suggestion of immediate rebasing, the applicants argued that the recommended approach was contrary to OEB policies that focus on incentives, outcome and performance. The applicants cited one of the key principles of the RRF, which refers to strong incentives to enhance utility performance.<sup>28</sup>

Alternatively, if the OEB was considering a deferred rebasing period, a majority of intervenors suggested a maximum deferred rebasing period of five years, although some argued for four or six years. OEB staff noted that the majority of Amalco's integration would be completed by 2024 and the utility would be in a position to file a rebasing application for 2025 rates.<sup>29</sup> In reply, the applicants emphasized the need for a ten-year deferral period as that is what they require to complete the amalgamation thoughtfully, thoroughly and effectively.

## OEB Findings

The OEB approves a deferred rebasing period of five years. The next rebasing application will therefore be expected for 2024 rates. The OEB finds that five years provides a reasonable opportunity for the applicants to recover their transition costs.

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<sup>25</sup> EB-2013-0202.

<sup>26</sup> EB-2012-0459.

<sup>27</sup> Applicants Reply, pages 33-34, paras 97-99

<sup>28</sup> Ibid, para 86.

<sup>29</sup> OEB staff submission, page 9

The OEB's policy of permitting a deferred rebasing period of up to ten years was adopted to incent the consolidation of electricity distributors.

For the gas utilities, Union Gas last rebased for 2013 and Enbridge Gas last rebased through a Custom IR application with a term from 2014 to 2018. To allow a further ten years before rebasing would result in 15 years without a rebasing application. During the last rate setting frameworks, both Union Gas and Enbridge Gas earned more than the OEB-approved return as evidenced by the earnings sharing mechanisms for both utilities. Customers will not benefit from any efficiency gains from this previous period until the end of the rebasing period.

The OEB agrees that the RRF is focused on the delivery of outcomes. These are assessed in part through the use of benchmarks which have been developed and applied for several years in the electricity distribution sector. In the absence of benchmarking on which to assess the performance of the applicants, and the resulting outcomes for their customers, the OEB has determined that 15 years is too long to go without a full review of their costs.

The OEB finds the wording in the Settlement Agreement for Union Gas' IRM Framework is not clear with respect to the rate-setting for 2019, though the wording implies there was an expectation that Union Gas would rebase its rates for 2019. The OEB is granting a five year deferred rebasing period consistent with its historic practice for other MAADs applications, and therefore is not requiring Union Gas to rebase for 2019.

The Settlement Agreement also required Union Gas to file costs at the time of rebasing. The OEB notes that the applicants did file significant historic and forecast costs as part of this application. Furthermore, in this Decision there are several findings that require the filing of costs as follows:

- As discussed in Section 5.9, the OEB is requiring Amalco to file a cost allocation study in 2019 to reflect the costs of certain large projects.
- Section 5.5 requires Amalco to file a consolidated utility system plan to support any application for an ICM for 2021 rates and beyond.
- Amalco is required to track the actual costs and amounts recovered through rates related to the Parkway Delivery Obligation during the deferred rebasing period, as discussed in Section 6.1.

### 5.3 Price Cap Adjustment

#### Inflation Factor

In its rate-setting application, the applicants proposed to use the quarterly Gross Domestic Product Implicit Price Index Final Domestic Demand (GDP IPI FDD) Canada index as the inflation factor. OEB staff submitted that the use of the GDP IPI FDD is acceptable, but stated a preference for a two-factor IPI that uses labour and non-labour inflation weighted by their contribution to costs, the approach currently used in the electricity sector in Ontario. OEB staff submitted that adoption of a two-factor IPI would ensure more consistency between natural gas and electricity sectors. In an undertaking response,<sup>30</sup> the applicants provided a comparison of the inflation factor using GDP IPI FDD and using both GDP IPI FDD and AWE (70/30 weighted). OEB staff agreed that the difference between the two methodologies was not material.

OGVG submitted that the OEB should use the two-factor IPI methodology consistent with that used for the electricity distributor, as using different methodologies for natural gas utilities and electric utilities had not been justified. OGVG further submitted that the ratio of capital and labour in the two-factor IPI should be customized for Amalco using Union Gas' and Enbridge Gas' ratio between labour and capital, as opposed to using the ratio adopted for electricity distributors.<sup>31</sup>

A number of intervenors such as SEC, BOMA, CCC, LPMA and CME supported using the GDP IPI FDD as the sole measure as it is a simpler approach.

In the event that the OEB determined that the price cap mechanism should use the GDP-IPI FDD as the sole inflation measure, OEB staff suggested that the manner in which the inflation change is measured be based on calendar year-over-year change, rather than the mid-year calculation currently used by natural gas distributors. This would make calculation and verification against Statistics Canada numbers easier. In reply, the applicants agreed.

In reply, the applicants expressed a preference for using the GDP IPI FDD but were willing to accept a two-factor IPI if the OEB considered that consistency between natural gas and electric utilities was important.

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<sup>30</sup> Undertaking Response J5.2.

<sup>31</sup> OGVG submission, page 17.



## OEB Findings

The OEB accepts the applicants' proposal to use GDP-IPI FDD for the inflation factor. This inflation factor has been adopted by the gas utilities in the past, and the applicants provided details that the GDP-IPI FDD and the two-factor inflation factor applied to electricity distributors have not been materially different since 1993.<sup>32</sup> The OEB accepts OEB staff's argument that verification of the inflation factor is easier if it is based on the calendar year-over-year change, therefore this proposal is adopted.

### Productivity Factor

The applicants proposed that the annual rate escalation be determined by a price cap index where PCI growth is driven by an inflation factor, less a productivity factor of zero and no stretch factor. In support of their proposal with respect to the productivity and stretch factor, the applicants submitted a report prepared by Dr. Jeff D. Makholm of National Economic Research Associates Inc. (NERA). OEB staff filed evidence of Dr. Mark Lowry of Pacific Economics Group Research LLC (PEG) titled "IRM Framework for the Proposed Merger of Enbridge and Union Gas". The study examined the nature of productivity research and its role in IRM design. The study also critiqued NERA's productivity research and provided an alternate productivity and stretch factor.

Both expert reports recommended the same base productivity factor of zero. However, OEB staff and CME criticized the methodology adopted by NERA. OEB staff and CME noted that NERA'S approach of using the "One Hoss Shay" method to measure capital cost does not recognize any deterioration of productive capability as opposed to PEG's recommendation of using a geometric decay method. CME further submitted that use of sales volume as opposed to customer numbers as an output measure artificially decreases the productivity results and was inappropriate and inapplicable to the applicants. Nevertheless, most intervenors and OEB staff agreed that the base productivity factor should be zero.

The applicants submitted that the OEB need not embark on a consideration of methodological issues when the outcome of both approaches is the same.

## OEB Findings

The OEB accepts the applicants' proposal for a productivity factor of 0% during the deferred rebasing period. There were two expert reports filed in evidence in this

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<sup>32</sup> Based on response to Undertaking J5.2.

proceeding on the productivity factor; one from NERA for the applicants and another from PEG for OEB staff. While the approach to determining an appropriate productivity factor differed, both experts recommended a productivity factor of 0%. Considering that the experts' recommendation is the same, the OEB will not opine on the merits of the methodology adopted in the reports.

### Stretch Factor

The applicants asserted that a stretch factor would not be appropriate as the applicants' productivity growth is in line with the economy as a whole and an economy-wide inflation is appropriate for setting rates during the deferred rebasing period. Further, the applicants expect to experience increasing cost pressures, depreciation increases, and interest rate increases that would put pressure on Amalco's earnings over the deferred rebasing period. The applicants relied on the expert evidence of NERA, which also concluded that a stretch factor of zero was appropriate. NERA argued that stretch factors may be warranted in a transition period between cost-of-service and IRM regimes, but not where IRM is firmly in place as it is with both Enbridge Gas and Union Gas.

PEG argued that a stretch factor of 0.3% was appropriate. PEG noted that it was difficult to assess the appropriate stretch factor, as the stretch factor is ordinarily determined using benchmarking analysis, and the applicants had not conducted a thorough benchmarking analysis for this application. Based on the data that it had available, PEG concluded that Union Gas was perhaps slightly more efficient than average, and Enbridge Gas slightly less. Using the OEB's policies for the electricity sector as a guide, PEG therefore placed Amalco in the "middle" cohort, and recommended a corresponding stretch factor of 0.3%.

Most interveners and OEB staff supported a stretch factor of at least 0.3%, and largely relied on the work of PEG. OEB staff argued that the OEB's longstanding practice and policy was to apply a stretch factor, both in the electricity and gas sectors. OEB staff further noted that the Rate Handbook is also clear that both gas and electric utilities should have a stretch factor under a price cap plan. They also disagreed with NERA that a stretch factor cannot be employed beyond the initial transition to incentive regulation, and referred to the OEB's RRF which provides for a stretch factor in subsequent IRM plans.

CME, OGVG and OEB staff identified the absence of benchmarking evidence as one of the main concerns with adopting a stretch factor of zero. LPMA and SEC noted in their submissions that over the 2014 to 2017 period, the average over-earnings of Union Gas was more than 57 basis points over the OEB allowed ROE and for Enbridge Gas, it was

more than 83 basis points. Accordingly, they submitted that the stretch factor should be 60% of the inflation factor, the same as is currently used in Union Gas' IRM plan.

In reply, the applicants argued that a balanced earnings sharing mechanism with a zero stretch factor will deliver the best outcome for customers. The applicants asserted that there is no policy direction from the OEB that a stretch factor cannot be zero; in fact, there are electricity distributors with a zero stretch factor. The applicants estimate that with a 0.3% stretch factor, Amalco would need to find additional savings of \$410 million, and with a 0.6% stretch factor, Amalco would earn significantly below allowed ROE. The applicants also argued that lack of benchmarking should not be a factor as a total cost benchmarking study has never been done for gas distributors in Ontario, and the benchmark work in Alberta was acknowledged by Dr. Lowry as experimental.<sup>33</sup>

## OEB Findings

The OEB finds that a stretch factor of 0.3% is appropriate during the deferred rebasing period.

In the absence of benchmarking evidence, the OEB is setting a stretch factor that is the mid-range of the stretch factors established for electricity distributors (0% to 0.6%). This is also the stretch factor approved in the decision for the hydroelectric generation business of Ontario Power Generation (OPG), where the OEB noted that it expects improved benchmarking going forward.<sup>34</sup> The mid-range is the stretch factor for an average performer. Without benchmarking, there is no clear evidence on the performance of either Enbridge Gas or Union Gas. As stated by Dr. Lowry: "There is certainly no evidence that they are a bad performer, but no evidence that they're good".<sup>35</sup>

A key objective of the OEB's incentive regulation is to drive improvements in cost efficiency. This would have been an expectation regardless of the amalgamation. The amalgamation provides additional opportunities to generate cost savings, and the applicants have proposed a number of initiatives for this purpose. The stretch factor provides incentive to find further efficiency improvements beyond those proposed.

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<sup>33</sup> Applicants' reply, page 47, para. 141.

<sup>34</sup> OEB Decision and Order EB-2016-0152, December 28, 2017

<sup>35</sup> Transcript Volume 4, page 164

When Amalco next seeks to set its stretch factor following the next rebasing application, the OEB will require Amalco to file benchmarking studies to support the assignment of a stretch factor.

#### **5.4 Earnings Sharing Mechanism**

The applicants have proposed an earnings sharing mechanism (ESM) in accordance with the MAADs Handbook. Accordingly, the ESM was proposed to start in year six of the ten-year deferred rebasing period. If in any calendar year from 2024 to 2028, the actual utility ROE is greater than 300 basis points above the allowed ROE, the excess earnings above 300 basis points would be shared 50/50 between the ratepayers and the shareholders.

Most intervenors who made submissions on ESM opposed the applicants' proposal. Intervenors and OEB staff submitted that the proposed ESM was beneficial to the shareholder and would not allow ratepayers to share in the savings. Some intervenors argued that the large deadband would essentially never be triggered. However, VECC accepted the proposed ESM if the deferred rebasing period was four years. For a longer deferred rebasing period, VECC proposed a sliding scale with respect to the proportion of sharing and threshold, which would benefit shareholders in the initial years and ratepayers in the latter part of the deferral period.

LPMA and CCC suggested an asymmetric ESM that begins in the first year of the deferred rebasing term with a deadband of 20 basis points. All earnings above that level would be shared equally between the shareholder and ratepayers. The approach was considered fair to both ratepayers and shareholder. SEC and CME proposed a similar ESM but with a deadband of 100 basis points.

OGVG submitted that the applicants had not demonstrated superior benchmarking performance to warrant a more rewarding ESM.<sup>36</sup> OGVG suggested adopting the current Union ESM that sets a deadband of 100 basis points with sharing of 50/50 with ratepayers beyond the threshold and 90/10 in favour of ratepayers beyond the 200 basis points threshold. OEB staff made a similar suggestion but recommended implementing the ESM from year four of a proposed six-year deferral period. OEB staff noted that the ESM policy in the Rate Handbook applies to electricity distributors and submitted that the applicants had not supplemented their original arguments to explain the basis for requesting the proposed ESM.<sup>37</sup>

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<sup>36</sup> OGVG submission, page 23.

<sup>37</sup> OEB Staff submission, page 10.

LPMA and OGVG further submitted that the earnings sharing should be based on weather normalized actual earnings, as it is these earnings, and not weather actual earnings, that will reflect the impact of efficiency gains, synergies, and other cost reduction measures achieved as a result of amalgamation.<sup>38</sup>

In reply, the applicants agreed that an ESM is the appropriate tool to achieve the objective of customer protection during the deferred rebasing period. The applicants submitted that determining an appropriate threshold for the ESM is important for Amalco to pursue deep and sustainable savings. The applicants suggested that if the OEB was concerned about additional customer protection, a balanced ESM over the ten-year deferred rebasing period with a zero stretch factor will deliver the best outcomes for customers.

## **OEB Findings**

The OEB approves an asymmetrical earnings sharing mechanism that will share earnings on a 50/50 basis between Amalco and its customers for all earnings in excess of 150 basis points from the OEB-approved return on equity.

Both Enbridge Gas and Union Gas have had earnings sharing mechanisms as fundamental components of their rate setting frameworks for many years. This is distinct from electricity distributors for which earnings sharing mechanisms have generally only been applicable for an amalgamation or acquisition. For this reason, the earnings sharing mechanism will be in effect from year one of the deferred rebasing period.

The earnings sharing mechanism under Union Gas' current IRM framework shares earnings on a 50/50 basis above 100 basis points and on a 90/10 basis above 200 basis points. The 150 basis points for the new earnings sharing mechanism is mid-way between the two existing thresholds, and results in a reasonable and simpler mechanism.

As proposed by the applicants, the earnings sharing mechanism will be on an actual basis (earnings not normalized for weather). Using actual earnings is a simpler approach to assessing the earnings that will be shared and it aligns the amount to be shared with customers with the actual earnings of Amalco each year.

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<sup>38</sup> LPMA submission, page 28.

## 5.5 Incremental Capital Module

The applicants have requested an ICM for the proposed ten-year Price Cap IR deferred rebasing period as allowed for in the MAADs Handbook. The ICM is a regulatory tool that allows for recovery of the revenue requirement for qualifying material and incremental capital additions, beyond what is funded through approved rates. Recovery is provided for through rate riders, which allow base rates to continue to be adjusted through the approved PCI formula.

The ICM policy and mechanism was first developed for the 3<sup>rd</sup> Generation IRM for electricity distributors,<sup>39</sup> and then was revised through reviews in 2014 and 2015 (collectively referred to as the ICM Reports).<sup>40</sup>

The applicants proposed to comply with the OEB's ICM policy with one exception – they proposed to use current long term debt and the current OEB issued ROE for determining the revenue requirement of any approved qualifying ICM project, instead of the current approved debt and ROE rates from the last rebasing.<sup>41</sup>

Testing of the evidence through interrogatories and during the Technical Conference and the oral hearing indicated that there were other areas where the applicants' ICM proposal deviated from OEB policy, as discussed in the submissions of OEB staff and some intervenors.

The applicants' rate-setting proposal would allow the majority of the capital costs in excess of the ICM materiality threshold to qualify for ICM treatment during the deferred rebasing period.

OEB staff and certain intervenors submitted that this was a misreading of the OEB policy. The OEB ACM<sup>42</sup>/ICM policy per the ICM Reports define ICM/ACM projects as being discrete, incremental, necessary, material, and not part of typical annual capital programs. The ICM is not a guaranteed recovery for amounts above the materiality threshold. OEB staff and other intervenors submitted that the applicants' proposal was not consistent with the OEB's ICM policy as documented in the ICM Reports and as articulated in decisions.

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<sup>39</sup> EB-2007-0673.

<sup>40</sup> *Report of the Board: New Policy Options for the Funding of Capital Investments: The Advanced Capital Module (EB-2014-0219)*, September 18, 2014 and *Report of the OEB: New Policy Options for the Funding of Capital Investments - Supplemental Report (EB-2014-0219)*, January 22, 2016.

<sup>41</sup> EB-2017-0307, Exhibit B/Tab 1/pp.15-16.

<sup>42</sup> Advanced Capital Module

While the applicants acknowledged these considerations at the Technical Conference,<sup>43</sup> they maintained that the majority of incremental capital additions will be afforded ICM treatment. This was particularly evident in the stand-alone versus amalgamated scenarios detailed in response to an interrogatory by FRPO,<sup>44</sup> and to subsequent analyses based on it, including Undertaking J4.2 (assuming a 0.3% stretch factor).

A review of FRPO interrogatory 11 showed that the applicants assumed that most of the forecasted capital expenditures exceeding the materiality threshold would be afforded ICM treatment. In the case of Enbridge Gas, all capital expenditures above the materiality threshold were assumed to qualify for ICM treatment in every year except 2019, where a small amount of about \$19 million is excluded. For Union Gas, there were amounts in most years where ICM funding was not expected, but, still, most capital expenditures exceeding the materiality threshold were assumed to qualify for recovery through the ICM over the proposed term plan.

Several intervenors submitted that the applicants' proposed ICM treatment was similar to the capital pass-through mechanism that is currently in place for Union Gas, and that the applicants' proposal was too favourable to Amalco and its shareholders. Accordingly, SEC, LPMA, CCC and OGVG proposed that the ICM be denied and that the capital pass-through mechanism, which is used in Union Gas' current Price Cap plan and is familiar to the utility and stakeholders, be used during the deferred rebasing period. LPMA submitted that the capital pass-through mechanism has worked well in the current Union Gas IR plan and it appropriately leaves the risk of recovery of the actual revenue requirement with the utility.

BOMA noted that the applicants' proposal to use Union Gas' 2013 rate base numbers to calculate the ICM threshold for legacy Union customers creates an artificially low materiality criteria, and a larger ICM capacity.

OEB staff supported the use of the ICM, but submitted that it should be treated the same way as in the electricity sector, both for electricity distributors and as available to OPG under the recently approved hydroelectric generation price cap plan.<sup>45</sup> OEB staff, LPMA and some other parties opposed the applicants' proposal that the updated cost of capital be used for each ICM.

While supporting the capital pass-through, if the ICM was adopted, LPMA submitted that the 10% deadband for the materiality threshold calculation should be replaced by a

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<sup>43</sup> Technical Conference Transcript, Vol. 3 (April 2, 2018), p. 152/l. 5 to p. 159/l. 11.

<sup>44</sup> Exhibit C.FRPO.11.

<sup>45</sup> EB-2016-0152

40% deadband.<sup>46</sup> In their reply argument, the applicants opposed this on the basis that this proposal was not tested on the record.

Some intervenors also raised the concern that the applicants do not have detailed five-year capital plans analogous to the Distribution System Plans (DSPs) that electricity distributors are required to prepare and file. DSPs allow for identification of individual capital projects and provide background for a utility's planned level of capital expenditures on a short- to mid-term horizon allowing the OEB to understand what is "normal" and what is incremental capital spending. OEB staff and some intervenors argued that the applicants need Utility System Plans (USPs)<sup>47</sup> to support proposed ICM applications. At the oral hearing, the applicants stated that they plan to file separate USPs as part of their 2019 rate application and to file a single asset management plan as quickly as possible.<sup>48</sup>

## OEB Findings

The OEB approves an ICM as discussed in this section. The OEB finds that it is appropriate to have a mechanism for the funding of incremental capital. Both Enbridge Gas and Union Gas had mechanisms for the funding of capital in their last rate frameworks; Enbridge Gas through its Custom IR forecast and Union Gas through its capital pass-through mechanism.

The OEB disagrees with the characterization of the ICM as a Y-Factor. Y-Factors have been defined as a mechanism for "passing through" certain costs. The ICM is a funding mechanism for significant, incremental and discrete capital projects for which a utility is granted rate recovery in advance of its next rebasing application. The ICM is not a capital pass-through mechanism.

The ICM policy for electricity distributors states that: "Any incremental capital amounts approved for recovery must fit within the total eligible incremental capital amount" and "must clearly have a significant influence on the operation of the distributor". The OEB has not established a project specific materiality threshold for electricity distributors to define "significant influence", and this has been determined on a case-by-case basis for other proceedings.<sup>49</sup> For greater regulatory certainty, the OEB has determined that, for

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<sup>46</sup> LPMA submission (June 15, 2018), p. 32.

<sup>47</sup> A Utility System Plan for gas utilities is analogous to a Distribution System Plan for electricity distributors.

<sup>48</sup> Transcript, Vol. 1, (May 3, 2018) REDACTED, p.95/l. 11 to p. 96/l. 12.

<sup>49</sup> e.g., [Decision and Order EB-2014-0116 \(Toronto Hydro-Electric System Limited\), December 29, 2015](#), section 3.4, and [Decision and Order EB-2017-0024 \(Alectra Utilities Corporation\), April 5, 2018](#), section 4.5.



Amalco, any individual project for which ICM funding is sought must have an in-service capital addition of at least \$10 million. This will reduce the chance that any proposed ICM project will be found not to be significant to Amalco's operations.

The OEB approves the proposed formula for calculating the materiality threshold for the ICM, including the 10% deadband. This formula is the same one used for the ICM for electricity distributors.

The eligible incremental capital amount will be determined using the OEB's ICM formula and each gas utility's rate base and depreciation, i.e. calculated individually for both Union Gas and Enbridge Gas. This is consistent with the policy for electricity distributors.

The OEB agrees with intervenors who noted that, through Union Gas' capital pass-through mechanism, significant capital additions have been funded through rates during the past IRM term. The rate base and depreciation associated with projects that were found eligible for capital pass-through treatment during the IRM term, shall be added to the 2013 OEB-approved rate base and depreciation in determining the eligible incremental capital amount for Union Gas' service territory.

For Enbridge Gas, the rate base and depreciation to be used in the formula shall be the 2018 OEB-approved amounts from the most recent Custom IR update decision.<sup>50</sup>

The OEB does not agree with the applicant's proposal to deviate from the ICM policy by using updated cost of capital parameters. The cost of capital parameters for the ICM funding will be the most recent OEB-approved for each of the Union Gas and Enbridge Gas legacy service areas.

Consistent with the ICM policy for electricity distributors, rate riders for any ICM would be determined as part of the rate proceeding in which the ICM is approved. The rate riders continue until the next rebasing application. In that rebasing application, the OEB will review the spending against plan to determine if any true-up is warranted.

The cost allocation for the ICM rate riders will generally be based on the most recent OEB-approved cost allocation. The OEB would consider an alternative cost allocation proposal filed with the ICM request if the nature of the capital project was such that cost causality was distinctly different from what underpins the OEB-approved cost allocation.

The applicants have indicated that they plan to file separate USPs as part of their 2019 rate application and to file a consolidated asset management plan as quickly as possible. The OEB finds it reasonable that a consolidated USP will not be available for

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<sup>50</sup> EB-2017-0086

2019 and 2020 rates, but expects the applicants to file separate USPs as planned. The OEB also expects that a consolidated USP will be filed for any ICM request for 2021 rates and beyond.

## 5.6 Y-Factors

Y factors are costs associated with specific items that are subject to deferral account treatment and passed through to customers without any price cap adjustment. The applicants propose to treat the following costs as Y factors:

1. Cost of gas and upstream transportation (in accordance with current QRAM treatment)
2. Demand Side Management (DSM) costs (in accordance with current DSM treatment)
3. Lost Revenue Adjustment Mechanism (LRAM; for the contract market)
4. Normalized Average Consumption/Average Use (the Applicants propose to continue to adjust rates annually to reflect the declining trend in use)
5. Cap-and-Trade (costs will be filed in future proceedings)
6. Capital investments that qualify for ICM treatment

The only submissions were on the applicants' proposal to true up Normalized Average Consumption (NAC) / Average Use (AU) on an annual basis to reflect the declining trend in average use. At the oral hearing, the applicants explained that the objective of the NAC and AU deferral accounts was not to reduce the weather risk. Since the load is weather normalized the deferral account essentially captures decline in average use not related to weather.<sup>51</sup>

OEB staff submitted that a structural break occurred in the average use models of Enbridge Gas in 2016 resulting in a significant difference between the actual normalized average use and the forecast average use.<sup>52</sup> OEB staff noted that the average use and load forecasting model had not been revised or reviewed since 2012 for both Enbridge Gas and Union Gas. However, OEB staff agreed with the continuation of the NAC/AU deferral accounts for now on the condition that Amalco be required to file a proposed

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<sup>51</sup> Transcript, Volume 5, pages 21-24, May 18, 2018.

<sup>52</sup> Staff submission, page 8 and response to Energy Probe IR#7, EB-2017-0102.

approach to discontinue the NAC/AU deferral and variance account at rebasing. OEB staff had no concerns with the other Y factors proposed by the applicants.

CCC, LPMA, Energy Probe and VECC submitted that the two average use accounts of Union Gas and Enbridge Gas should be discontinued and reviewed at rebasing. CCC maintained that the utilities have continually been shielded from declines in average use without any corresponding reductions in the cost of capital.<sup>53</sup> LPMA submitted that the lost revenue adjustment mechanism (LRAM) should be expanded to include the lost revenue associated with DSM programs for general service customers. LPMA submitted that Union Gas had agreed to file a study assessing the continued appropriateness of the NAC methodology but has not done so. VECC questioned the different treatment between natural gas and electric utilities. Natural gas utilities are protected against declines in gas consumption due to reasons other than DSM programs while electric utilities are offered no protection against general declines in consumption. VECC suggested that the OEB should convene a proceeding to examine the issue of NAC/DSM to ensure it adheres to the same principles as electricity LRAM/CDM.<sup>54</sup>

At the hearing, the applicants explained that if they are not permitted to recover declines in average use, there would not be any motivation for the utilities to aggressively pursue conservation initiatives. However, the applicants noted that they do intend to review the approach to NAC/AU. In reply, the applicants proposed that Amalco will consult with stakeholders to work towards a single, revenue-neutral approach to NAC/AU for a future rate application.

## OEB Findings

The OEB approves the Y factors as proposed by the applicants, with the exception of the ICM discussed in the previous section and the Cap-and-Trade costs. The treatment of Cap-and-Trade costs will be addressed in a separate proceeding.

In its argument-in-chief, the applicants proposed that Amalco consult with stakeholders to work towards a single, revenue-neutral approach to NAC/AU for a future rate application. Given the shortened deferred rebasing period, the OEB requires the applicants to develop a proposal to be filed with its next rebasing application. This should include a proposal for an LRAM mechanism that includes general service

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<sup>53</sup> CCC submission, page 14.

<sup>54</sup> VECC submission, page 18.

customers. If Amalco proposes to continue using the NAC/AU, it must file evidence in support of that approach.

## 5.7 Z-factor

The applicants proposed a Z-factor to deal with costs that are outside the control of management and represent costs that are related to a non-routine event and clearly outside of the base upon which rates are derived. The applicants initially proposed using a materiality threshold of \$1.0 million for Amalco during the deferred rebasing period, which is in line with the threshold for electricity distributors in Ontario.

Intervenors who made submissions did not agree with the proposed threshold. VECC and OEB staff noted that there are Z-factors in place for both utilities (Enbridge Gas – \$1.5 million and Union Gas – \$4 million) under their current rate setting plans. OEB staff submitted that both utilities have been able to manage within their respective thresholds. VECC submitted that the threshold should be at least \$5.5 million, which is the total of current thresholds for Enbridge Gas and Union Gas. OEB staff suggested OPG's materiality threshold of \$10 million as the basis for determining an appropriate threshold. As such, Amalco's threshold should be \$7.5 million in proportion to the revenue requirement of Amalco and OPG. At the same time, a number of intervenors recommended a threshold of \$10 million in line with the threshold for OPG. LPMA submitted that the current threshold for Union Gas is \$4.0 million and therefore a threshold between \$8 million and \$10 million for Amalco was appropriate.

OEB staff further submitted that Amalco should not be able to claim a rise in borrowing costs as a Z-factor. OEB staff noted that Amalco's treasury function resided at Enbridge Inc. and Amalco's debt costs would be impacted by the credit rating of Enbridge Inc. OEB staff maintained that if there is any downgrade in Enbridge Inc.'s credit rating, the cost of borrowing could increase significantly and this could adversely impact the ratepayers of Amalco. OEB staff submitted that the cost of borrowing is clearly within the control of management and does not qualify to be a Z-factor. OGVG raised a similar concern.

In reply, the applicants submitted that the comparison made to OPG for purposes of determining Amalco's Z-factor materiality threshold was not appropriate and that OPG was an entirely different entity than a gas distributor. However, the applicants agreed that Amalco's threshold should not be lower than the current thresholds of Enbridge Gas and Union Gas. Accordingly, the applicants agreed that the Z-factor materiality threshold for Amalco should be equal to the combined threshold for Enbridge Gas and Union Gas, which is \$5.5 million. With respect to the cost of borrowing qualifying as a Z-

factor, the applicants submitted that the OEB does not need to determine in this proceeding what types of costs might qualify for Z-factor treatment.<sup>55</sup>

## OEB Findings

The OEB approves the inclusion of a Z-factor mechanism in the rate-setting framework for costs that meet all of the four criteria set out below. A material claim is defined by any cost resulting in a revenue requirement impact in excess of a materiality threshold of \$5.5 million. This is the sum of the current Z-factor thresholds for Union Gas (\$4 million) and Enbridge Gas (\$1.5 million).

The criteria for the Z-factor will be as established by the OEB in Enbridge Gas' Custom IR decision as follows:<sup>56</sup>

- (i) Causation: The cost increase or decrease, or a significant portion of it, must be demonstrably linked to an unexpected, non-routine event.
- (ii) Materiality: The cost at issue must be an increase or decrease from amounts included within the Allowed Revenue amounts upon which rates were derived. The cost increase or decrease must meet a materiality threshold, in that its effect on the gas utility's revenue requirement in a fiscal year must be equal to or greater than \$5.5 million.
- (iii) Management Control: The cause of the cost increase or decrease must be: (a) not reasonably within the control of utility management; and (b) a cause that utility management could not reasonably control or prevent through the exercise of due diligence.
- (iv) Prudence: The cost subject to an increase or decrease must have been prudently incurred.

Given the criteria, the OEB agrees with the applicants that it is not necessary to make a ruling on whether any particular type of cost, such as the cost of debt, is eligible for a Z-factor. It will be up to Amalco to file evidence on how all of the criteria have been met.

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<sup>55</sup> Applicant reply, pages 52-53, para. 157.

<sup>56</sup> EB-2012-0459 Decision with Reasons pages 19 and 20.

## 5.8 Base Rate Adjustments

The applicants have proposed to make four adjustments to base rates:

### 1. Union Gas Deferred Tax Drawdown

The applicants propose to increase Union Gas' 2018 OEB-approved revenue by \$17.4 million pre-tax (\$12.8 million after-tax) to recognize the accumulated deferred tax balance. This amount represents the difference between the credit to ratepayers included in 2018 rates, and the accumulated deferred tax balance at the end of 2018 of zero. Since the balance is zero, Union Gas has proposed to remove the benefit from rates.

### 2. Enbridge Gas CIS and Customer Care Costs

The applicants propose to decrease Enbridge Gas' 2018 OEB-approved revenue by \$4.9 million to recognize the approved customer information system (CIS) and customer care cost level of \$126.2 million rather than the \$131.1 million in 2018 OEB-approved rates.

### 3. Enbridge Gas Pension and OPEB Costs

In the 2018 Rate Adjustment proceeding,<sup>57</sup> the OEB did not permit Enbridge Gas to include certain pension and Other Post-Employment Benefits (OPEB) costs in rates. The costs were associated with amendments to the *Pension Benefits Act* legislation and the OEB did not allow cost recovery as the Bill had not yet been formally passed. Parties agreed in the revised settlement proposal that Enbridge Gas would recover the actual amount of its pension and OPEB costs and related revenue requirement in 2018 through amounts to be recorded in the Post-Retirement True-Up Variance Account (PTUVA). On December 14 2017, Bill 177 received Royal Assent. Therefore, Enbridge Gas is proposing to adjust its 2018 OEB-approved revenue requirement by \$6.5 million (increase) to account for the impact of amendments to the *Pension Benefits Act* legislation.

### 4. Enbridge Gas Tax Deduction related to SRC Refund

In Enbridge Gas' Custom IR proceeding (2014-2018),<sup>58</sup> the OEB approved a revised methodology for determining the net salvage percentages to be used by Enbridge Gas in the calculation of its depreciation rates, called the Constant Dollar Net Salvage (CDNS) approach. In addition to approving this new

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<sup>57</sup> EB-2017-0307.

<sup>58</sup> EB-2012-0459.

approach, the OEB also approved a proposal to return to ratepayers, through a rate rider (Rider D), certain amounts that had been recovered through past depreciation rates based on the traditional method for determining net salvage percentages. The 2018 revenue requirement approved in the Custom IR proceeding included \$11.2 million in expected tax deductions arising from the SRC refund payments to ratepayers. The applicants have proposed to remove the \$11.2 million in tax deductions that are currently embedded in Enbridge Gas' approved 2018 revenue requirement because there is no longer any ongoing SRC refund and therefore the associated tax deductions will no longer be available in years following 2018.

OEB staff, BOMA, LPMA, SEC and CCC had no objection to the proposed adjustments.

SEC and CCC suggested additional base rate adjustments and submitted that the revenue requirement of the two merging utilities should be reduced by the grossed-up value of their 2018 earnings in excess of the 2018 allowed ROE for each of the utilities. SEC submitted that the 2017 over-earnings could be used as a proxy and adjusted later against 2018 over-earnings.

LPMA submitted that the OEB should reduce the 2018 revenue requirement by \$23 million for Enbridge Gas and \$11.3 million for Union Gas. LPMA argued that in the absence of rebasing, it is only through these base rate adjustments that ratepayers can receive the benefits that should be passed through to them at the end of an IR plan term and before the beginning of the next IR plan.<sup>59</sup>

In reply, the applicants disagreed with base rate adjustments related to over-earnings. According to the applicants, without rebasing there is no way of knowing the extent to which earnings of Enbridge Gas and Union Gas over the period 2014-2018 reflect efficiencies and savings that carry forward into 2019. The applicants argued that such adjustments would be arbitrary considering that there was evidence that certain drivers such as tax deductions cannot be presumed to carry forward into 2019.

## **OEB Findings**

The OEB approves the four proposed base rate adjustments outlined above. No parties argued against these adjustments. The OEB will not make additional base rate adjustments as proposed by some intervenors. Absent rebasing, it is not clear what the

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<sup>59</sup> LPMA submission, page 16.

drivers of the over-earnings are and whether they will be sustainable during the deferred rebasing period. Furthermore, a requirement to rebase certain elements upon an amalgamation would be contrary to the purpose of a deferred rebasing period.

## 5.9 Cost Allocation and Rate Design

### Cost Allocation

The applicants have not proposed any changes to cost allocation as part of this application. However, at the hearing, the applicants noted that they intend to propose cost allocation changes to the Panhandle and St. Clair system in the next rate application.

OEB staff argued that discrete cost allocation changes were not appropriate in the absence of a comprehensive cost allocation study. Intervenors such as OGVG, LPMA and CCC agreed. OGVG noted that the OEB has repeatedly rejected requests to consider cost allocation changes for isolated projects outside of a comprehensive system-wide cost allocation study.<sup>60</sup>

APPrO, Kitchener and IGUA submitted that Union Gas should be directed to undertake a new cost allocation study immediately to resolve known issues including transportation rates and the over-allocation of costs to power generators and other large customers as a result of the Panhandle Reinforcement project. These intervenors argued that it was unacceptable that significant cost allocation inequities be allowed to continue for another ten years. They noted that the OEB has stated its expectation that these costs would be addressed prior to Union Gas entering into another Price Cap IR in 2019.

SEC argued that cost allocation and rate design issues warrant the applicants filing for early rebasing.

In reply, the applicants reiterated the commitment to complete a cost allocation study for each of the years 2022 and 2026 using OEB-approved methodologies. Each of the cost allocation studies would be subject to a consultative process with intervenors. The applicants noted that it expects Amalco to be kept whole with respect to its revenue forecast for any prospective shifting of costs between rate classes as a result of the cost allocation study.<sup>61</sup>

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<sup>60</sup> OGVG submission, page 13, Decision in EB-2016-0186 and EB-2017-0087.

<sup>61</sup> Reply submission, page 23.



TransCanada raised a cost allocation/rate design issue that impacts its C1 rate. In the Union Gas proceeding to modify the C1 rate schedule, the OEB approved the C1 Dawn to Dawn-TCPL transportation rate based on Dawn transmission compression related costs and recovery of costs associated with the capital investment.<sup>62</sup> The OEB approved the two-part rate design outlined above as well as Union Gas' request to recover the entire capital costs over a five-year term matching TransCanada's initial underlying contract. The contract is up for renewal at the end of October 2018 and TransCanada submitted that the specific assets are fully depreciated and the rate should be significantly lower than currently charged. TransCanada noted that Union Gas is currently recovering \$547,000 of capital-related costs in rates that is already recovered. TransCanada submitted that the remedy to the situation is simple and does not require a change in cost allocation. TransCanada submitted that the OEB could reduce the revenue requirement of the C1 Dawn to Dawn TCPL service and this would not have any consequences for other shippers as the asset is fully depreciated. Union Gas' two-part rate design further facilitates the removal of costs from the Amalco revenue requirement.<sup>63</sup>

## OEB Findings

Amalco is expected to prepare and file a comprehensive cost allocation proposal to be filed with its next rebasing application following the five year deferred rebasing period.

However, the OEB is concerned about the cost allocation issues raised by parties for Union Gas' Panhandle and St. Clair systems. The OEB therefore requires Amalco to file a cost allocation study in 2019 for consideration in the proceeding for 2020 rates that proposes an update to the cost allocation to take into account the following projects: Panhandle Reinforcement, Dawn-Parkway expansion including Parkway West, Brantford-Kirkwall/Parkway D and the Hagar Liquefaction Plant. This should also include a proposal for addressing TransCanada's C1 Dawn to Dawn TCPL service. The OEB accepts that this proposal will not be perfect, but is intended to address the cost allocation implications of certain large projects undertaken by Union Gas that have already come into service.

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<sup>62</sup> EB-2010-0207

<sup>63</sup> TCPL submission, pages 1 and 2.

## Rate Design

SEC argued that Amalco's plan to adjust annual rates could result in some customers, including schools, experiencing larger than average increases. SEC and LPMA submitted that any rate formula should be applied equally to each component of distribution rates, including monthly charges, volumetric charges at each band level and storage charges.<sup>64</sup>

In reply, the applicants clarified that any proposal for rate changes will have to be approved by the OEB. The applicants noted that they are seeking approval of a price-setting framework and any proposals as to how rates would be set will be made in subsequent proceedings.

## **OEB Findings**

The bill impacts provided in this proceeding assumed that the fixed monthly charge would remain constant and rate adjustments would be applied to the variable charges.<sup>65</sup> The applicants stated that this approach is not their rate design proposal, and that a rate design proposal would be filed as part of the 2019 rate application. The OEB accepts the applicants' approach of proposing its rate design in the 2019 rate application, and will not determine in this proceeding the appropriate approach to rate design. However, the OEB notes that the bill impacts provided in this proceeding showed that the approach of applying all rate increases to the variable rate resulted in material bill impacts to certain customers. Any proposal for rate design must address this issue.

### **5.10 Rate Harmonization**

The MAADs Handbook notes that electricity distributors are expected to propose rate structures and rate harmonization plans following consolidation at the time of rebasing. They are not required to file details of their rate-setting plans, including any proposals for rate harmonization, as part of the application for consolidation.<sup>66</sup>

Consistent with this approach for electricity distributors, the applicants have not filed a plan to harmonize rates. At the oral hearing, the applicants indicated that Amalco would consider harmonization of rates over the deferred rebasing period, and to the extent that

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<sup>64</sup> SEC submission, pages 50-51.

<sup>65</sup> Transcript Volume 6, page 8

<sup>66</sup> Handbook to Electricity Distributor and Transmitter Consolidations, Page 17, January 19, 2016.

rates can be harmonized, Amalco would bring forward a proposal for consideration of the OEB.<sup>67</sup>

OEB staff and OGVG accepted the position of the applicants but OEB staff recommended that the applicants seriously consider rate harmonization for the Enbridge Gas Greater Toronto Area franchise and Union Gas south at the time of rebasing. VECC expressed similar views. LPMA submitted that rate harmonization can only be reviewed after Amalco has harmonized all other aspects of its operations and definitely not during the deferred rebasing period. SEC submitted that Amalco should be required to provide at the time of rebasing a detailed analysis of rate harmonization options and their impacts as well as the utility's preferred approach.

In reply, the applicants stated that they could bring forward a study regarding harmonization at the five-year mark that would be the subject of stakeholder consultation. This would allow parties to provide input prior to the harmonization proposal at rebasing.

## **OEB Findings**

Amalco shall file a proposal for rate harmonization in its next rebasing application. This is not a requirement to harmonize rates, it is a requirement to file a proposal about harmonization. This is consistent with the approach for electricity distributors, and most parties agreed that harmonization should be considered with the next rebasing application.

As part of this proposal for rate harmonization, Amalco is required to file a proposal with respect to the use of excess natural gas storage from the Union Gas territory as discussed in Section 6.

### **5.11 Off-Ramp**

The applicants have not proposed an off-ramp. In the RRF, the OEB determined that each rate-setting method will include a trigger mechanism with an annual ROE deadband of +/- 300 basis points.<sup>68</sup> When a distributor performs outside of the earnings deadband, a regulatory review may be initiated.

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<sup>67</sup> Oral Hearing Transcript, Volume 3, page 66, May 14, 2018.

<sup>68</sup> RRF, page 11.

In response to an interrogatory, the applicants clarified that they had not proposed an off-ramp as they had selected a deferred rebasing period of ten years and included the earnings sharing mechanism as directed by the OEB in the MAADs Handbook.<sup>69</sup>

## OEB Findings

While the applicants have not proposed an off-ramp, the OEB is adopting during the deferred rebasing period the off-ramp as described for electricity distributors in the RRF. This is consistent with the MAADs Handbook. If non weather normalized earnings during the deferred rebasing period are outside of +/- 300 basis points from the OEB-approved ROE, a regulatory review may be triggered. This is to ensure an additional level of protection for both customers and Amalco. This regulatory review may be undertaken administratively by the OEB as part of the OEB's ongoing performance monitoring of utilities.

### 5.12 Deferral and Variance Accounts

The Rate-Setting Mechanism application includes a list of deferral and variance accounts that the applicants propose be continued and a list of those whose closure is requested.

OEB staff had no concerns with the continuation of the accounts proposed by the applicants but disagreed with the closure of two deferral accounts.

With respect to the closure of Enbridge Gas' Earnings Sharing Mechanism Deferral Account (ESMDA), OEB staff submitted that Amalco must use a variance account to track sharing amounts that may be generated during the deferred rebasing period for both legacy utilities. This is the typical approach used for tracking prior period balances. OEB staff's proposed approach would require Amalco to create a new Earnings Sharing Deferral Account for the new entity.

With respect to the Post-Retirement True-Up Variance Account (PTUVA), OEB staff submitted that it should remain in operation until at least the end of 2019 as there is a smoothing mechanism currently in place. If the balance in the account (either debit or credit) is greater than \$5 million, the incremental amount (beyond \$5 million) is carried forward into a future year. Accordingly, OEB staff submitted that the account should remain open until such time that any residual balance in the account is disposed of.

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<sup>69</sup> Response to OEB Staff IR#20

The applicants proposed to close Union Gas' Tax Variance Deferral Account (TVDA). The TVDA captures 50% of the difference between the actual tax rates and the approved tax rates included in rates resulting from, among other things, changes to federal and/or provincial tax legislation. The applicants have instead proposed that any significant changes in taxes occurring during the deferred rebasing period that are outside of management's control will be addressed through the Z factor. OEB staff submitted that Union Gas' TVDA should not be closed and should continue to capture any tax variances resulting from factors such as changes in federal and/or provincial tax legislation during the deferred rebasing period. OEB staff further submitted that Enbridge Gas should open an equivalent TVDA to be used for the same purpose. OEB staff noted that Z-factor adjustments are subject to threshold restrictions and therefore would not address tax variances below the threshold.

LPMA, CCC and Energy Probe submitted that NAC/AU deferral accounts should be discontinued. Energy Probe submitted that the request to continue more than 50 deferral accounts is concerning from a regulatory efficiency perspective and transfers risk to ratepayers.

In reply, the applicants agreed with OEB staff to keep the PTUVA account open in case there is a residual balance. However, the applicants disagreed with the continuation of the tax variance account (TVDA) as it only captures variances in HST input tax credits, the calculation of which will become increasingly complex through the amalgamation.

## **OEB Findings**

The OEB accepts the applicants' proposal for the accounts that will be continued, with the exception of the Cap-and-Trade deferral and variance accounts which will be addressed in a separate proceeding. The other accounts were previously approved by the OEB and the underlying issues that resulted in the establishment of these accounts still remain.

The OEB accepts the applicants' proposal for the accounts that will be discontinued, with the exception of the PTUVA and TVDA. The OEB can assess whether the PTUVA should be discontinued in a subsequent rate application once it is clear there is no residual balance.

With respect to the TVDA, the OEB agrees that the applicants can cease recording the impact of the introduction of HST. The effort to track this is at odds with the materiality of the balances being recorded. However, the OEB will keep the TVDA but expand its applicability to record the impact of any tax rate changes for both Enbridge Gas and Union Gas legacy areas, i.e. all of Amalco.

Having approved an ESM, the OEB agrees with the submission of OEB staff that the ESM amount (50% of the earnings in excess of 150 basis points above the OEB-approved ROE) should be recorded in an Earnings Sharing Deferral Account. The OEB is therefore establishing this account. The account will record the ratepayer share of utility earnings that result from the application of the earnings sharing mechanism as determined in this Decision. The calculation of the utility return for earnings sharing purposes will include all revenues that would otherwise be included in earnings and only those exemptions (whether operating or capital) that would otherwise be allowed from earnings within a cost of service application.

### **5.13 Changes to Accounting Policies**

Amalco will report under USGAAP financial standards. During the deferred rebasing period, the applicants expect to change accounting policies and practices as part of the implementation of an integrated accounting system, including changes in the calculation of depreciation rates and its cost capitalization policy. In its argument-in-chief, the applicants proposed that Amalco provide annual reporting to the OEB with regard to the financial impacts of accounting changes until all changes due to harmonization have been implemented. When all changes have been implemented, Amalco proposed to report to the OEB on the net financial impact of the changes and to put forward a proposed treatment of any material net impact. LPMA supported the proposed approach.

OEB staff submitted that the applicants each be required to open a new deferral account that captures the revenue requirement impacts associated with the integration of their accounting policies and practices during the deferred rebasing period. The balances in the accounts should be subject to an OEB prudence review and may be brought forward for disposition at the applicants' next rebasing application.

OGVG and LPMA agreed that the impact of these changes should be tracked in a deferral account.

In reply, the applicants disagreed with the suggestion of establishing a deferral account to capture impacts of the integration of accounting policies and practices. The applicants submitted that it was unnecessary and inappropriate to make a determination regarding the establishment of such accounts at this time.

**OEB Findings**

The OEB is establishing a deferral account to record the impact of any accounting changes required as a result of the amalgamation that affect revenue requirement. The OEB is not determining the approach to disposition of this account at this time. Amalco should propose an approach to disposition of any balances in its application for 2020 rates.

It is not known at this point whether the impact of any accounting changes will be material, but there is the potential for a material balance. The deferral account will ensure the balance is recorded for review by the OEB. If the balance in the deferral account turns out not to be material, the OEB can then determine whether the account should be closed.

## 6 TRANSPORTATION AND STORAGE

The OEB has determined that issues raised with respect to review of the Natural Gas Electricity Interface Review (NGEIR) decision<sup>70</sup> and the Storage and Transportation Access Rule (STAR) are outside of the scope of this proceeding. However, as considerable hearing time was devoted to these important issues, the OEB has included a summary of the discussion of these topics, and other background issues in Appendix A. The Findings for this section relate only to two issues:

- The Parkway Delivery Obligation (PDO)
- The treatment of excess storage from the Union Gas legacy system

### 6.1 Parkway Delivery Obligation

In the 2013 rates proceeding,<sup>71</sup> Union Gas' large volume direct purchase customers requested that Union Gas eliminate the Parkway Delivery Obligation (PDO) and allow customers to deliver gas at Dawn in place of Parkway because the cost to these customers to maintain the obligation exceeded the delivery rate benefit of the obligation. Union Gas' large volume direct purchase customers east of Dawn have an obligation to deliver gas at Parkway (the Parkway Delivery Obligation). The main issue was that Union Gas needed the gas at Parkway and not Dawn, and had planned its gas supply on that basis. In Union Gas' 2014 rates application,<sup>72</sup> the OEB approved a framework for the reduction of the PDO. This approved framework resulted from an agreement between Union Gas and the parties on the PDO issue. As a result of that agreement, Union Gas recovered in rates each year an estimated amount representing the capacity that it could move from Dawn to Parkway based on availability. The estimated foregone revenue as a result of using the transportation capacity to move the needed gas from Dawn to Parkway was recovered from ratepayers.

FRPO noted that the settlement agreement for PDO explicitly intended to keep Union Gas whole through the IRM period. However, FRPO argued that Union Gas has enhanced earnings as a result of the implementation of the PDO and ratepayers are paying twice for the same capacity. Union Gas charged ratepayers for the temporarily

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<sup>70</sup> EB-2005-0551, NGEIR Decision with Reasons, November 7, 2006, page 74 and 83.

<sup>71</sup> EB-2011-0210.

<sup>72</sup> EB-2013-0365.



available capacity at an incremental cost to facilitate the PDO reduction. In addition, Union Gas has expanded the Dawn-Parkway system, which has further expanded surplus capacity, the costs of which are already recovered in rates. FRPO claimed that there is an equivalent of 200 TJ of Dawn-Parkway capacity that ratepayers are now paying in rates representing PDO reduction costs. Since the amount is less than the 210 TJ of original surplus, FRPO argued that ratepayers are paying twice for the 200 TJ. Accordingly, FRPO submitted that the ratepayer contribution of \$9.7 million in rates representing PDO costs should be removed as a base rate adjustment for Union South customers.

Alternatively, if the OEB was of the opinion that there is insufficient evidence to make such a determination, FRPO submitted that the OEB should order the applicants to file sufficient evidence detailing the costs and recoveries of the Dawn-Parkway system throughout the deferred rebasing period to justify the continuing inclusion of PDO reduction costs. LPMA supported the position of FRPO on the PDO issue.

In reply, the applicants rejected FRPO's claim that ratepayers are paying twice. The applicants submitted that the PDO has been eliminated in precisely the manner contemplated and agreed to by the parties in the PDO settlement agreement. The implementation of the PDO has resulted in in-franchise customers requiring firm Dawn-Parkway capacity on design day that is incremental to the original allocation of Dawn-Parkway costs from the 2013 OEB approved cost allocation methodology. The applicants maintained that in-franchise ratepayers are paying for costs not previously allocated to them; they are not paying twice as claimed by FRPO.

The applicants also rejected the notion that there is surplus or excess capacity. The applicants noted that they are at risk for any surplus capacity as the revenue of that forecast is built into rates. If the applicants fail to meet the forecast, they bear the loss.

## **OEB Findings**

The OEB has determined that there is insufficient evidence to determine whether, as a result of the implementation of the PDO, ratepayers are paying twice for the same capacity. The OEB requires Amalco to track actual costs and amounts recovered through rates related to the PDO during the deferred rebasing period. The OEB at the time of rebasing will review the costs and amounts recovered through rates to ensure that ratepayers are not paying twice for the required capacity and the legacy Union Gas is not enhancing earnings contrary to the intent of the PDO settlement agreement.

## 6.2 Storage

In the NGEIR proceeding,<sup>73</sup> the OEB determined that 100 PJ of Union Gas' existing storage capacity and all of Enbridge Gas' storage capacity of 99.4 PJ would be allocated to meet the needs of in-franchise customers at cost-based rates. While Enbridge Gas has insufficient storage to meet the needs of its in-franchise customers, Union Gas has excess storage. Enbridge Gas therefore purchases storage services from Union Gas at market-based rates. Union Gas' in-franchise customers typically use around 93 PJs annually with the balance being sold as short-term storage. The net revenues from short-term storage and load balancing transactions are shared 90:10 to the benefit of ratepayers.

OEB staff argued that upon amalgamation, Enbridge Gas customers should receive the benefit of Union Gas' excess utility storage. In an undertaking response, the applicants provided a hypothetical analysis of the net benefit to Enbridge Gas customers if market-based storage was replaced with cost based excess utility storage space from Union Gas from 2013 to 2017.<sup>74</sup> The analysis revealed that the net benefit to Enbridge Gas customers would have outweighed the forgone net benefit to Union Gas customers as a result of not receiving revenues from the sale of excess utility storage. OEB staff argued that there should not be any distinction between Enbridge Gas and Union Gas in-franchise customers; all in-franchise customers of Amalco should have access to utility storage that has been allocated to in-franchise customers as per the NGEIR Decision.

LPMA opposed the position of OEB staff on this issue. LPMA submitted that any change in the excess utility storage space and the net revenues generated from it, would result in harm to Union Gas ratepayers as they currently receive a net benefit in rates of \$4.5 million a year. In addition, if Union Gas customers require more capacity in the future, LPMA submitted that Union Gas would have to obtain additional capacity at market-base rates, rather than use the cost-based storage that was specifically set aside for their future use in the NGEIR decision.<sup>75</sup>

The applicants in reply supported LPMA's submission on the issue of allocating excess utility storage of Union Gas to customers of Enbridge Gas noting that it does not meet the no harm test.

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<sup>73</sup> EB-2005-0551, NGEIR Decision with Reasons, November 7, 2006, page 74 and 83.

<sup>74</sup> Undertaking JT2.12.

<sup>75</sup> LPMA submission, page 13.

**OEB Findings**

During the deferred rebasing period, the OEB accepts the applicants' proposal to continue to purchase market-based storage services to meet the needs of legacy Enbridge Gas in-franchise customers. Amalco is required to file a proposal, with its rate harmonization plan discussed in Section 5, for the ongoing approach to the use of excess natural gas storage from the legacy Union Gas service territory to meet the storage needs of the legacy Enbridge Gas in-franchise customers. This will ensure that legacy Union Gas customers continue to benefit from the sale of market-based storage until issues of rate harmonization are considered.

## 7 MONITORING PERFORMANCE AND RATES PROCESS

### 7.1 Scorecard

The applicants proposed a single scorecard for Amalco to measure and monitor performance over the deferred rebasing period. The proposed scorecard is modelled after the electricity distributors' scorecard and includes measures for customer focus, operational effectiveness, public policy responsiveness and financial performance.<sup>76</sup>

The scorecard metrics include a combination of existing metrics, Service Quality Requirements (SQRs) and best practice metrics. The applicants maintain that the use of existing SQRs would help ensure that Amalco's progress can be compared relative to its predecessors.

VECC noted that the proposed scorecard has no means of gauging customer satisfaction with either rate structures or the rates themselves and therefore does not allow the OEB to monitor customer satisfaction with the amalgamation.

LPMA commented that approval of the proposed scorecard in this proceeding should not prevent any party from bringing forward changes or additions to the proposed scorecard during the deferred rebasing period in a future proceeding. LPMA suggested that the OEB consider, as a customer protection measure, penalties applicable to Amalco if it fails to meet the standards on any of the items included in the scorecard.<sup>77</sup>

OEB staff noted that, while Amalco intends to track the electricity distributors' scorecard in terms of safety, reliability, customer focus and financial performance, it has not proposed to track cost control in the scorecard as is done for the electricity distributors. OEB staff submitted that the proposed scorecard should also track cost control measures during the deferred rebasing period (e.g., total cost per customer and total cost per km of distribution pipeline). In addition, OEB staff recommended that the scorecard also track net savings on an annual basis.

In reply argument, the applicants accepted that cost per customer information could be included in the proposed scorecard as a cost control metric. However, the applicants expressed concerns about what tracking "net savings" means and how it might be accomplished.

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<sup>76</sup> Report of the Board – Performance Measurement for Electricity Distributors: A Scorecard Approach, March 5, 2014.

<sup>77</sup> LPMA submission, page 37.

## OEB Findings

The OEB accepts the scorecard proposed by the applicants, with the inclusion of the measures on total cost per customer and total cost per km of distribution pipeline as proposed by OEB staff. The OEB notes that it can amend the scorecard through revisions to GDAR if different or additional reporting is determined to be required.

### 7.2 Unaccounted For Gas

In the 2016 Earnings Sharing Mechanism proceeding,<sup>78</sup> Enbridge Gas agreed to review potential metering issues that might be contributing to Unaccounted for Gas (UAF), and to report on that review. In the Enbridge Gas 2018 rates amended settlement proposal, Enbridge Gas agreed to continue this review and report on the progress in the 2019 rate-setting application.<sup>79</sup>

However, in response to an interrogatory, the applicants noted that the issue of UAF would be addressed in the 2029 rebasing proceeding and not in 2019.<sup>80</sup> The applicants were of the opinion that this issue is best considered and dependent on a comprehensive review within the eventual amalgamated entity and structure. In its submission, OEB staff did not see any convincing reason to delay the review until 2029.

## OEB Findings

The OEB considers the issue of Unaccounted for Gas (UAF) important and requires Amalco to file a report on this issue for both the Union Gas and Enbridge Gas service areas by December 31, 2019.

### 7.3 Stakeholder Meetings

The applicants proposed to jointly host a funded stakeholder meeting every other year starting in 2019 to review such things as financial results, market conditions, capital projects, customer engagement, integration activities and gas supply planning.

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<sup>78</sup> EB-2016-0142

<sup>79</sup> Amended Settlement Proposal, Enbridge Gas Distribution Inc. 2018 Rate Adjustment, Schedule 1, page 13, December 6, 2017

<sup>80</sup> OEB Staff IR# 59(a).

APPrO, CME and OEB staff suggested that annual stakeholder meetings would be more appropriate and useful.

In reply argument, the applicants accepted the suggestion of annual stakeholder meetings if the OEB finds merit in them.

## **OEB Findings**

The OEB will not order Amalco to have annual stakeholder meetings. Consistent with the OEB's approach to customer engagement, the utility should determine the best approach to engage stakeholders. The OEB notes that stakeholder meetings held during the previous rate-setting terms have been informative and have assisted in providing both the OEB and stakeholders on both historic and prospective issues.

### **7.4 Rates Process**

In terms of the annual rate setting process during the deferred rebasing period, the applicants proposed to file any required applications (including a draft rate order) no later than September 30 each year such that a final rate order can be issued by December 15 of that year for implementation by January 1 the following year.<sup>81</sup>

LPMA expressed concern that some applications may be complex and require extra lead-time.

The applicants further noted that the OEB should not be prescriptive about filing dates.

## **OEB Findings**

The OEB is not determining the process for rates applications as part of this proceeding. This is generally not a matter that is adjudicated.

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<sup>81</sup> EB-2017-0307, Application, Exhibit B-1, page 26.

## 8 IMPLEMENTATION ISSUES

At the oral hearing, the applicants indicated that the decision to proceed with amalgamation will depend on the rate framework that is approved by the OEB.<sup>82</sup> SEC submitted that this is unusual and once the OEB establishes the rate rules, the applicants should live with them. SEC maintained that the applicants should not be allowed to keep coming back to the OEB with different proposals until they get a decision they like. However, SEC did agree that in this case, the applicants do have the right not to proceed with the amalgamation. SEC further noted that in its opinion virtually all of the savings as a result of the proposed amalgamation are available regardless of whether the applicants decide to amalgamate or not. If the OEB approves a rate framework on the basis of amalgamation, SEC expected the OEB to implement rates on that basis regardless of whether the applicants proceed with amalgamation. SEC submitted that the OEB should inform the applicants that unless there is a successful review or appeal, the OEB expects their decision on rates to be respected and implemented.<sup>83</sup>

LPMA submitted that the OEB should not let the implied threat of not amalgamating post the decision of the OEB influence the decision on any of the issues in the proceeding.

The applicants in reply denied that the decision to proceed with the amalgamation depends on whether they like the OEB's decision at the conclusion of the proceeding. However, the applicants clarified that if the OEB issues a decision that makes significant changes to the applicants' proposal, then the applicants would consider their plans for amalgamation in view of the decision.

### OEB Findings

If the applicants determine that they will not proceed with the amalgamation, the OEB expects both Union Gas and Enbridge Gas to file rebasing applications, either cost of service or Custom IR, as soon as possible. The leave to amalgamate will expire 18 months from the date of this Decision and Order. If the determination not to proceed with the amalgamation is made before this expiry, the applicants are expected to notify the OEB.

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<sup>82</sup> Transcript, Vol. 1, page 12.

<sup>83</sup> SEC submission, pages 8-9.

## 9 ORDER

### THE ONTARIO ENERGY BOARD ORDERS THAT:

1. Enbridge Gas Distribution Inc. and Union Gas Limited are granted leave to amalgamate to form Amalco.
2. The applicants shall promptly notify the OEB of the completion of the amalgamation.
3. The leave granted in paragraph 1 shall expire 18 months from the date of this Decision and Order.
4. The deferred rebasing period shall be five years.
5. During the deferred rebasing period, Amalco shall adopt the rate setting framework as determined in this Decision and Order.
6. During the deferred rebasing period:
  - a. Amalco shall ensure that any employment impacts resulting from the amalgamation will be managed on a roughly proportionate basis between the Municipality of Chatham-Kent and the City of Toronto;
  - b. To the extent that Centres of Excellence are created in either the Municipality of Chatham-Kent or the City of Toronto, the Centres of Excellence shall reflect a range of skills and compensation levels, including leadership roles;
  - c. Employment within the Municipality of Chatham-Kent shall reflect a mixture of entry, middle and senior level roles; and
  - d. Amalco will commit to a process of regular communication and engagement with the Municipality of Chatham-Kent in respect of the amalgamation and its related impacts and opportunities.
7. The applicants shall file with the OEB and deliver to the intervenors, draft accounting orders related to the deferral and variance accounts set up or approved by the OEB in this Decision and Order by **September 10, 2018**. This includes the Amalco Earnings Sharing Mechanism Deferral Account, Amalco Tax Variance Deferral Account and Amalco Accounting Policy Change Deferral Account effective January 1, 2019.



8. The OEB approves the continuation of deferral and variance accounts as proposed in the application, with the exception of the Cap-and-Trade deferral and variance accounts which will be dealt with in a separate proceeding.
9. The following deferral and variance accounts will be eliminated effective December 31, 2018:

Enbridge Gas

179-16	Customer Care CIS Rate Smoothing Deferral Account
179-34	Constant Dollar Net Salvage Adjustment Deferral Account
179-96	Relocations Mains Variance Account
179-98	Replacement Mains Variance Account
179-58	Earnings Sharing Mechanism Deferral Account

Union Gas

179-120	CGAAP to IFRS Conversion Costs
179-134	Tax Variance Deferral Account (replaced by new Amalco account)

10. Intervenor and OEB staff shall file any comments on the draft accounting orders with the OEB and forward them to the applicants on or before **September 18, 2018**.
11. The applicants shall file with the OEB and forward to the intervenors responses to any comments on its draft accounting orders on or before **September 24, 2018**.
12. Cost eligible intervenors shall file their cost claims with the OEB and the applicants on or before **September 27, 2018**.
13. The applicants shall file with the OEB and forward to intervenors any objections to the claimed costs by **October 5, 2018**.
14. Intervenor shall file with the OEB and forward to the applicants any responses to any objections for cost claims by **October 12, 2018**.
15. The applicants shall pay the OEB's costs incidental to this proceeding upon receipt of the OEB's invoice.

**DATED** at Toronto, August 30, 2018

**ONTARIO ENERGY BOARD**

*Original Signed By*

Kirsten Walli  
Board Secretary

# **APPENDIX A**

## **Submissions Related to Transportation and Storage**

## Transportation

The applicants' evidence on gas supply focused on the status of the existing contracts between Enbridge Gas and Union Gas. Enbridge Gas relies on long-term contracts with Union Gas for transportation and storage of natural gas to meet the gas supply requirements of customers in Enbridge Gas' franchise areas. Transportation services are provided at regulated rates and storage services are provided at market prices. The cost consequences of these contracts are passed through to customers in rates. The applicants noted that despite the fact that the contracts will cease to have effect upon amalgamation, Amalco plans to treat current contractual arrangements as continuing services for the existing terms of the pre-amalgamation contracts.

The applicants confirmed that there is no difference in the costs allocated to the Enbridge Gas rate zone as a result of treating Enbridge Gas as an in-franchise customer (as opposed to a M12 ex-franchise customer). In other words, the amalgamation would not impact transportation costs for Enbridge Gas customers. None of the parties expressed any concerns with respect to the transportation contracts. However, APPrO and TransCanada did express concerns with the allocation of transportation capacity and how other customers of Amalco would be treated versus the legacy Enbridge Gas customers with respect to the awarding of transportation capacity.

TransCanada noted that Enbridge Gas' shift from ex-franchise to in-franchise as a result of amalgamation would represent a significant change in the Dawn Parkway system. Using 2017/2018 volumes, TransCanada estimated that in-franchise use of the Dawn-Parkway system will rise from 28% to 66% as a result of the movement of Enbridge Gas volumes from ex-franchise to in-franchise. TransCanada submitted that the change in the use of the system should result in a review of service attributes to ensure fair competition, fair and equal access, non-discrimination, and adherence with the principles of user-pay/cost causation.<sup>84</sup>

TransCanada noted that currently in-franchise customers are able to adjust volumes on a firm basis throughout the day, whereas C1 and M12 (ex-franchise) transportation customers may only adjust their nominations on an interruptible basis. Secondly, if it is uneconomic to expand facilities to fully accommodate the entirety of a capacity expansion requested by shippers, Amalco's in-franchise customer needs would not be subject to proration, whereas all ex-franchise bids would be prorated on remaining capacity. TransCanada submitted that C1 and M12 shippers face discrimination in the provision of transportation service due to the free no-notice service option and preferential access to expansion capacity provided to Amalco in-franchise transportation

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<sup>84</sup> TransCanada submission, page 3.

customers. Accordingly, TransCanada submitted that the OEB should direct the applicants to allocate costs incurred in the provision of higher quality in-franchise service to in-franchise customers and further direct the applicants to allow ex-franchise customers the right to contract for a M12 service with similar attributes to those provided to in-franchise customers (for example, an M12 no-notice service).<sup>85</sup>

The applicants in reply noted that with respect to nominations, M12 and C1 shippers have the ability to nominate all of their firm transportation capacity on the timely window to ensure it is scheduled. With respect to the prioritization of service, the applicants submitted that in-franchise needs and M12 firm needs are at the same priority level and this would not change with amalgamation. The applicants further added that if parties need access to firm intraday increases to timely window nomination, they can contract for all day firm service that is rate-regulated. With respect to expansion capacity and concerns of capacity proration, the applicants noted that Amalco would continue to award bids based on highest economic value as Union Gas does today, with longer term needs driving higher net present value. Available capacity would continue to be provided on a first-come, first-served basis.

### **Storage Transportation and Access Rule**

As noted earlier, Enbridge Gas does not have sufficient storage to meet the needs of its in-franchise customers while Union Gas has excess storage that is not rate-regulated. Post amalgamation, Amalco would continue to purchase market-based storage services to meet the needs of legacy Enbridge Gas in-franchise customers. Since Amalco is one of the parties that can provide storage services, it would be purchasing storage at market-based rates from itself. In order to ensure an unbiased storage procurement process, Amalco has proposed that it would conduct a blind request for proposals through an independent third party for storage capacity. At the oral hearing, the applicants confirmed that if Amalco purchased market-based storage from itself, the contract would be publicly reported on its website in accordance with the Storage and Transportation Access Rule (STAR).<sup>86</sup> OEB staff was satisfied with the proposed approach.

However, FRPO expressed concerns with respect to the transparency of storage and transportation transactions. FRPO submitted that it would be beneficial to view past indices and future contracts as it would provide a better picture of the storage market. Given that STAR is a decade old and the markets would change with the creation of

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<sup>85</sup> Ibid., pages 4-5.

<sup>86</sup> Transcript, Volume 3, Page 118, May 14, 2018.

one major Ontario utility, FRPO submitted that a review of STAR was in the public interest. LPMA submitted that the OEB should have a consultative process where any impacts of the merger on OEB policies, rules or orders could be discussed.

The applicants in reply submitted there was no reason to review STAR at this time. The applicants have committed to post the design day Dawn-Parkway system capacity required for Union North, Union South and Enbridge Gas zones on an aggregated basis on its website as part of the Index of Transportation Customers.

### **Other Storage Issues**

CME noted that Enbridge Gas purchases market based storage for their customers and Union Gas still has excess cost-based regulated storage. Considering that the NGEIR decision did not envision the amalgamation of Enbridge Gas and Union Gas, CME submitted that the OEB should review the allocation and regulation of natural gas storage in Ontario when Amalco rebases. BOMA expressed similar views suggesting an independent expert study, the terms of reference for which should be agreed between Amalco and intervenors. The study would assess options and make recommendations to rationalize gas storage and transportation that would also include an assessment of the NGEIR decision.<sup>87</sup> CCC and VECC made similar submissions. Energy Probe submitted that the OEB should either consider having one pool of regulated storage, move it all to market-based rates or re-open the NGEIR decision.<sup>88</sup>

With respect to revisiting the policy decisions made in NGEIR, the applicants submitted that there was no reason to revisit NGEIR in light of the proposed amalgamation. In the NGEIR decision, the OEB determined that the storage market is sufficiently competitive within the geographic market identified by the OEB. In fact, the analysis of Charles River Associates has found that the competitive market for storage is similar to, or potentially larger than the competitive market region identified by the OEB in the NGEIR decision.<sup>89</sup>

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<sup>87</sup> BOMA submission, page 20.

<sup>88</sup> Energy Probe submission, page 14.

<sup>89</sup> Reply submission, page 61, para 183.