

1. BACKGROUND TO THE APPLICATION AND HEARING

1.1 THE APPLICATION

1.1.1 On July 31, 1997, Centra Gas (Ontario) Inc. (“Centra”) a predecessor of Union Gas Limited (“Union” or the “Company”) filed an application (the “Application”) with the Ontario Energy Board (the “Board”) for an order or orders under sections 9 and 10 of the *Municipal Franchises Act*, R.S.O. 1990, c. M.55, as amended, (the “MFA”) for approval of the terms and conditions and for renewal, or extension of, the franchise for the Township of Pittsburgh. The Board assigned the Application file No. E.B.A. 825. On September 9, 1997, the Board issued its first Interim Order extending the franchise until October 24, 1998.

1.1.2 On October 15, 1998, shortly before the expiry of first Interim Order, Union submitted a second application to the Board under section 10 of the MFA for an order renewing the term of the right to operate the works for the distribution of gas in that portion of the City of Kingston (“City”, “new City”, “Kingston” or “new Kingston”) which was formerly the Township of Pittsburgh. The Board assigned this application file No. 872. For this purposes of the current proceeding the Board relied on the E.B.A. 825 application.

1.2 BACKGROUND

1.2.1 Effective December 5, 1955, the Corporation of the Township of Pittsburgh (“Pittsburgh”) entered into a franchise agreement (the “1955 Franchise Agreement”) with Lakeland Natural Gas Limited (“Lakeland”), a predecessor of Centra and Union, to provide natural gas within the boundaries of the Township of Pittsburgh. The terms and conditions of the agreement were approved by the Ontario Fuel Board, the predecessor of the Board, and a Certificate of Public Convenience and Necessity was issued on March 28, 1956.

1.2.2 Effective October 14, 1977, Pittsburgh entered into a new franchise agreement (the “1977 Franchise Agreement”) with Lakeland’s successor, Northern and Central Gas Corporation Limited, to provide natural gas in Pittsburgh until October 24, 1997. The 1977 Franchise Agreement was approved by the Board.

1.2.3 On January 7, 1997, the Minister of Municipal Affairs and Housing signed an order (the “Restructuring Order”) under subsection 25.2 of the *Municipal Act* R.S.O. 1990, c. M.45 as amended by . S.O. 1996 C-1 Sch M, s.1 and S.O.1997, c.26, Sch to implement a proposal for restructuring for the City of Kingston (“old Kingston” or “old City”), the Township of Kingston (“Kingston Township” or the “former Township of Kingston”), and Pittsburgh (or the “former Township of Pittsburgh”). Section 3.1 of the Restructuring Order provided that effective January 1, 1998, old Kingston and the former Townships of Kingston and Pittsburgh and their local boards would be dissolved and a new city named The Corporation of the City of Kingston would be incorporated.

1.2.4 In June 1997, Centra approached Pittsburgh with a request to renew the 1977 Franchise Agreement. In light of the pending municipal restructuring, the matter was dealt with by the Transition Board, which consisted of the Mayor of old Kingston and the Reeves of the former Townships of Pittsburgh and Kingston. The Transition Board agreed that it would be appropriate, in the circumstances of the anticipated amalgamation, to renew the 1977 Franchise Agreement on an interim basis.

- 1.2.5 On July 30, 1997, Centra filed an application with the Board for an order or orders under sections 9 and 10 of the MFA for approval of the terms and conditions and for renewal or extension of the franchise for Pittsburgh. Centra also applied, with the consent of the Transition Board, for an interim one year extension of the franchise. On September 9, 1997, the Board issued its first Interim Order extending the franchise until October 24, 1998. Centra amalgamated with Union effective January 1, 1998.
- 1.2.6 The Restructuring Order took effect on January 1, 1998 and incorporated the new City of Kingston to govern as a single municipality encompassing the area of the three former municipalities.
- 1.2.7 On August 10, 1998, Union wrote to the Kingston City Clerk requesting approval of its request to renew the franchise for the area of Kingston formerly encompassed by the former Township of Pittsburgh. On October 14, 1998 the City, through Utilities Kingston, advised Union the City had decided that Utilities Kingston would provide natural gas distribution services in Pittsburgh, as well as in the old City.
- 1.2.8 On October 15, 1998, shortly before the expiry of the first Interim Order, Union submitted a second application to the Board under section 10 of the MFA for an order renewing the term of the right to operate the works for the distribution of gas in that portion of the City of Kingston which was formerly the Township of Pittsburgh. By letter dated October 21, 1998, Union informed the Board that it was unable to reach an agreement with Kingston with respect to a franchise renewal for Pittsburgh and requested an extension of the first Interim Order. On October 26, 1998, the Board issued a second Interim Order, on a without prejudice basis and with the consent of Kingston and Union, extending Union's franchise rights in the former Township of Pittsburgh until the franchise renewal could be considered, or at the latest April 24, 1999.

- 1.2.9 On December 2, 1998, Kingston filed a motion (the “Motion”) challenging the Board’s jurisdiction to deal with the Application.
- 1.2.10 On December 15, 1998, Kingston City Council passed a resolution approving “all necessary steps to ensure that consumers within the former Pittsburgh Township received the lowest cost, safe and reliable supply of natural gas by any means permissible by law, including the acquisition of the existing assets required for the distribution of natural gas in the former Township of Pittsburgh”.
- 1.2.11 On February 25, 1999, the Board heard the Motion and issued its oral decision confirming the Board’s jurisdiction to hear the franchise renewal application.
- 1.2.12 On March 9, 1999, the Board issued a procedural order calling for evidence, interrogatories and responses to be filed by April 12, 1999.
- 1.2.13 On March 11, 1999, Kingston advised Union that its Council was considering a by-law under section 62 of the *Public Utilities Act*, R.S.O. 1990, c. P.52, as amended, (“PUA”) to acquire the works and property of Union in the former Township of Pittsburgh.
- 1.2.14 The Board issued its Notice of Hearing on April 14, 1999, setting a hearing date of May 19, 1999. By letter dated May 12, 1999, signed jointly by Union and Kingston, the parties requested an adjournment of the hearing, pending an attempt to negotiate a settlement of the issues. The Board granted the requested adjournment and issued a third Interim Order, extending the franchise until August 24, 1999.
- 1.2.15 In June 1999, Council passed a by-law in order to effect the acquisition of Union’s gas distribution assets in the former Township of Pittsburgh.
- 1.2.16 The Board issued further Interim Orders on August 23, 1999 extending the interim franchise until December 24, 1999 and on November 23, 1999 extending the franchise expiry date to June 24, 2000.

1.2.17 On August 6, 1999, the Ministers of Municipal Affairs and of Energy Science and Technology wrote to the Mayor of Kingston and indicated that, subject to approval by the Legislature, the Government intended to repeal section 62 of the PUA. On December 22, 1999, section 62 of the PUA was repealed retroactive to January 1, 1999.

1.3 THE HEARING

1.3.1 A hearing of the Application was held on December 11 and 12, 1999. Written arguments were submitted by the parties on January 21, 2000. Oral arguments were heard on January 31, 2000 and February 2, 2000.

1.3.2 The following representatives appeared at the hearing:

Glenn Leslie	Union Gas Limited
Sharon Wong	

Guy Pratte	City of Kingston
Kevin LaRoche	

Fred Cass	The Consumers' Gas Company Ltd.
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Jennifer Lea	Board Counsel
Michael Lyle	Board Solicitor

1.3.3 Union called the following Company witnesses:

John Wellard	Senior Vice President, Asset Management
Jane Peverett	Senior Vice President, Finance and Business Services
Michael Deschesne	Eastern District Manager
Paul Dhaen	Senior Analyst, Financial Analysis
Michael Packer	Manager, Rates and Pricing
Harold Pankrac	Team Leader, Rates and Pricing

1.3.4 The City of Kingston called the following witnesses:

Gary Bennett	Mayor, City of Kingston
Bert Meunier	Chief Administrative Officer, City of Kingston
James Keech	General Manager, Utilities Kingston
Nancy Taylor	Assistant General Manager, Utilities Kingston

1.3.5 A complete record of the proceedings, together with exhibits, is available for public inspection at the Board's offices.

1.3.6 The Board has considered the evidence, submissions and arguments in the Application, but has only referenced them to the extent necessary to provide background to its decision.

2. STATUTORY FRAMEWORK

2.0.1 Three principal statutes deal with the provision of natural gas to residents of Ontario: the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch. B (the “OEB Act”); the *Public Utilities Act*; and the *Municipal Franchises Act*.

2.1 ONTARIO ENERGY BOARD ACT (THE “OEB ACT”)

2.1.1 The OEB Act deals with the general jurisdiction of the Board to regulate the production, transmission, distribution and storage of natural gas in Ontario. The OEB Act does not deal explicitly with the Board’s jurisdiction regarding the renewal of franchises. However, subsection 19(6) of the OEB Act provides that:

The Board has exclusive jurisdiction in all cases and in respect of all matters in which jurisdiction is conferred on it by this [the OEB Act] or any other Act.

2.1.2 Section 23 of the OEB Act grants the Board broad powers in making orders, including the power of the Board to “impose such conditions as it considers proper”. In addition an order of the Board may be “general or particular in its application”.

2.2 THE PUBLIC UTILITIES ACT (THE “PUA”)

2.2.1 The PUA deals with a broad range of public utilities, including natural gas.

2.2.2 Subsection 18(1) of the PUA provides that a municipality “may manufacture, procure, produce and supply for its own use and the use of the inhabitants of the municipality any public utility ... and for such purposes may purchase, construct, improve, extend, maintain and operate any works that may be considered requisite”.

2.2.3 Section 28 of the PUA provides that a municipal council may pass by-laws for the maintenance and management of the public utility works and the conduct of the officers and employees in connection with them. A council may also fix rates or charges for supplying the public utility.

2.2.4 Section 58 of the PUA provides that a company (as distinct from a municipal utility) shall not exercise any of its powers within a municipality unless a by-law of the council of the municipality has been passed authorizing such action, with the assent of the electors as may be required by the MFA.

2.2.5 The effect of the PUA is to vest in the municipalities, in the first instance, the right to establish and operate municipal gas utilities and to allow private companies to operate in a municipality under the authority of a municipal by-law.

2.3 THE MUNICIPAL FRANCHISES ACT (THE “MFA”)

2.3.1 The MFA was first enacted in 1912. Section 3 of the MFA provides that a municipal by-law granting, extending or renewing a right to construct or operate a public utility must set forth the terms and conditions upon which and the period for which such right is to be granted and that the by-law must receive the assent of the electors.

2.3.2 In 1933, the MFA was amended with the addition of section 8, which prohibited any person from constructing any work to supply gas unless a certificate of public convenience and necessity had been obtained from the Ontario Municipal Board. Section 8 was later amended to confer certification authority on the Ontario Fuel Board and later on the Board. Section 8 of the MFA did not replace the requirement that a utility must obtain a franchise from the municipality.

2.3.3 The MFA was further amended in 1954 with the addition of section 9, which deals with the original grant of the franchise. Section 9 of the MFA now provides:

9(1) No by-law granting,

(a) the right to construct and operate works for the distribution of gas;

(c) the right to extend or add to the works mentioned in clause (a); or

(d) a renewal of or an extension of the term of any right mentioned in clause (a)

shall be submitted to the municipal electors for their assent unless the terms and conditions upon which and the period for such right is to be granted, renewed or extended have first been approved by the Ontario Energy Board.

2.3.4 Section 10 was added to the MFA in 1969. Prior to that time both a utility and a municipality had a common law right to terminate a franchise upon the expiry of the franchise agreement. Section 10 is specifically intended to allow the Board to implement a renewal of a franchise where there is no agreement between the municipality and the utility and to allow the Board to determine the terms of the franchise being renewed. Section 10 of the MFA, as amended, now provides, in part:

10(1) Where the term of a right ... to operate works for the distribution of gas has expired or will expire within one year, either the municipality or the party having the right may apply to the Ontario Energy Board for an order for a renewal of or an extension of the term of the right.

(2) The Ontario Energy Board has and may exercise jurisdiction and power necessary for the purposes of this section and, if public convenience and necessity appear to require it, may make an order renewing or extending the term of the right for such period of time and upon such terms and conditions as may be prescribed by the Board, or if public convenience and necessity do not appear to require a renewal or extension of the term of the right, may make an order refusing a renewal or extension of the right. ...

(5) An order of the Board heretofore or hereafter made under subsection (2) renewing or extending the term of the right ... shall be deemed to be a valid by-law of the municipality concerned assented to by the municipal electors for the purposes of this Act and section 58 of the Public Utilities Act.

2.3.5 Therefore in order for the Board to exercise its jurisdiction under section 10 of the MFA the Board must consider the following criteria:

- the term of the right to operate works for the distribution of gas has expired or will expire within one year and either the municipality or the party having the right has applied to the Board for an order for a renewal of or an extension of the term of the right;
- “public convenience and necessity” require the Board to make an order renewing or extending the term of the right, or “public convenience and necessity” do not require the Board to renew or extend the right; and
- the Board can impose appropriate terms and conditions.

3. POSITIONS OF THE PARTIES

3.1 UNION'S PROPOSAL

3.1.1 Union has requested the Board to issue an order under section 10 of the MFA renewing the term of its right to operate the works for the distribution of gas in that portion of the City of Kingston which was formerly the Township of Pittsburgh. Union has suggested that the terms and conditions imposed by the Board should be those of the existing model franchise agreement. However, Union recognized that the Board is considering amendments to the model franchise agreement and Union indicated it would be amenable to the Board imposing the terms and conditions of any new model franchise agreement.

3.2 KINGSTON'S PROPOSAL

3.2.1 Kingston has been providing gas and electrical service within its boundaries since it acquired the Kingston Light, Heat and Power Company in 1904. Responsibility for gas and electricity, as well as water works, was given over to a Public Utility Commission in 1913. "Town Gas" produced by coal gasification was replaced with natural gas service when the utility was connected to the TransCanada PipeLines ("TCPL") system in 1958.

- 3.2.2 Kingston was providing gas utility service prior to 1933 and therefore has been exempt from the necessity of obtaining a certificate of public convenience and necessity under section 8 of the MFA in respect of construction of gas distribution facilities in the old City of Kingston. Kingston is also exempt from rate regulation by the Board by virtue of subsection 36(8) of the OEB Act.
- 3.2.3 During the 1950's through to the 1990's the City received several offers to purchase Kingston's gas utility, including offers from Lakeland, ICG Utilities (Ontario) Ltd., The Consumers' Gas Company Ltd., and Centra. These offers were rejected by the City. Kingston operates one of two municipal gas utilities in Ontario (the other is Kitchener). Utilities Kingston now serves approximately 10,800 natural gas customers, comprised of 8,800 residential, 1,904 commercial, and 13 small and large industrial customers.
- 3.2.4 Kingston pointed out that at no time prior to the municipal restructuring with the Townships of Pittsburgh and Kingston had Kingston ever evinced any intention of providing gas services in either of Union's franchise areas in the former Townships of Pittsburgh and Kingston. It was as a result of the restructuring, a product of the policy of the provincial government to enhance efficiency of municipal government, that the City decided to operate a single gas distribution system in both the former Townships of Pittsburgh and Kingston. Union has a franchise agreement for the former Township of Kingston that expires in 2004.
- 3.2.5 Kingston proposed that the Board order that operational responsibility for the distribution of gas in the former Township of Pittsburgh be transferred to Kingston as soon as a transition could be operationally accomplished (the "transition date"). By the transition date, Union would transfer operation of the distribution works in the former Township of Pittsburgh to Kingston, including the responsibility for maintaining and replacing Union's existing distribution plant in the former Township of Pittsburgh. New plant required for the distribution system, either for replacement or growth, would be paid for and owned by Kingston.

- 3.2.6 Kingston would pay Union for Kingston's exclusive use of Union's distribution plant located in the former Township of Pittsburgh, including the Joyceville Lateral and the Barriefield Lateral. This amount would recover the undepreciated capital costs of Union's distribution plant (including the costs of the laterals) at the composite depreciation rate determined by the Board, from time to time, in Union's rates cases. The consideration payable by Kingston to Union would be derived annually from the declining undepreciated capital costs of Union's distribution plant in the former Township of Pittsburgh. The consideration would be paid by Kingston to Union over the remaining economic life of the distribution plant, until the plant had been fully depreciated or replaced by Kingston.
- 3.2.7 Kingston would also pay Union an amount to compensate Union for the actual costs of transmission service on the Barriefield Lateral, as agreed by the parties or, in the absence of any agreement, as determined by the Board following a hearing.
- 3.2.8 If, after determining the amounts payable to Union for the first year, Kingston decided that it did not wish to proceed with its proposal, then Kingston would be deemed to have consented to the renewal of Union's franchise pursuant to section 9 of the MFA on the terms and conditions requested by Union.
- 3.2.9 The City proposed that any matter that the parties could not resolve themselves pertaining to the interpretation and/or implementation of the Board order would be resolved by the Board in the manner prescribed by the Board.

3.3 PUBLIC CONVENIENCE AND NECESSITY

- 3.3.1 In considering the proposals of parties, the key issue for the Board to determine is "public convenience and necessity". The MFA does not define "public convenience and necessity" nor does it set specific criteria that the Board should apply in determining whether the franchise should be renewed. The parties have suggested a number of factors that the Board should take into account in making its determination.

Legislative Context

- 3.3.2 Union submitted that the exercise of the Board's discretion under section 10 of the MFA should be made within the context of its governing statutes and should be consistent and governed by the purposes and interests which the statutes seek to protect.
- 3.3.3 It was Union's position that important factors which are to govern the manner in which the Board exercises its discretion include: the purpose of section 10 of the MFA; the objectives of the Board as set out in section 2 of the OEB Act; previous OEB decisions regarding its jurisdiction under section 10; and previous judicial decisions establishing that the municipality has no power to encroach on the Board's exclusive jurisdiction.
- 3.3.4 Section 2 of the OEB Act sets out the objectives that are to guide the Board in carrying out its responsibilities in relation to gas. Union pointed out that, in particular, paragraphs 2 and 3 of section 2 of the OEB Act require the Board to seek to maintain just and reasonable rates for the transmission, distribution and storage of gas and to facilitate rational expansion of transmission and distribution systems.
- 3.3.5 Union's position was that when determining the public interest and what is required for public convenience and necessity, the only factors which the Board is entitled to take into account are public interest factors related to the regulation and control of the transmission, distribution, sale and storage of gas, and that the Board is not endowed with power to make decisions which only promote the aims of individual municipalities, including raising revenue for municipalities.

Deference to Wishes of City Council

- 3.3.6 Kingston's evidence was that the City had decided, through its duly elected Council, that the interests of the City, including the former Township of Pittsburgh, required that the franchise with Union not be renewed. Kingston submitted that the Board should show substantial deference to the City's decision and should not interfere unless the decision was patently unreasonable. The City contended that this approach is consistent with the primacy of municipal consent to the grant of franchises which is embedded in the relevant statutory framework.
- 3.3.7 Union countered Kingston's position with the proposition that section 10 of the MFA would serve no purpose if the municipality's wishes were paramount or determinative of when a franchise should be renewed and that just because a municipality wants a particular outcome does not mean that it is necessarily in the public interest. In support of this position Union pointed out that section 10 of the MFA allows the Board to impose terms contrary to the municipality's wishes.
- 3.3.8 Union pointed out that in the preliminary motion brought by the City, the Board has already ruled that it has jurisdiction to entertain this Application, even though the City does not want the franchise renewed.
- 3.3.9 Union agreed that while the Board can consider the municipality's wishes, the Board should also consider other relevant factors. Union argued that if the Board were governed solely by the municipality's wishes that would be de facto delegation of the Board's discretion and such delegation would be improper.
- 3.3.10 Union pointed out that section 10 was added to the MFA in 1969. Prior to that time both the municipality and the utility had common law rights to terminate a franchise upon the expiry of the franchise agreement. Section 10 was specifically intended to allow the Board to implement a renewal of a franchise where there was no agreement between the municipality and the utility.

Reasonable Expectation of Renewal

- 3.3.11 Union contended that its shareholder and management had a “reasonable expectation” that its franchise would always be renewed provided Union fulfilled its franchise obligations. Although Union acknowledged that it did not have a “right” to perpetual renewal, it also took the position that it was entitled to renewal if it continued to provide superior service and to meet its obligations.
- 3.3.12 Kingston interpreted Union’s argument to mean that the Board should limit its view of public convenience and necessity to determining whether Union had met its franchise obligations. Kingston countered that there is no factual evidence to support this “expectation”. Union did not deny that neither the Township nor the City contributed to such an expectation; that Union had never communicated such an expectation to the Township or the City; and that neither the 1955 nor the 1977 Franchise Agreement contained an automatic right of renewal.
- 3.3.13 The City argued that the Board’s consideration of public convenience and necessity is not limited to refusing to renew a franchise only in those situations where the franchisee has breached its franchise obligations. That would, in Kingston’s view, be redundant, since in such a situation, the municipality would have the contractual right to terminate the franchise. In addition, there is no indication that the Board can only terminate a franchise in circumstances of force majeure, which again would not require the Board’s intervention, since frustration would by normal operation of contract law principles lead to termination of the franchise.
- 3.3.14 Union argued that a reasonable expectation of renewal is realistic and that enduring franchises are an implicit assumption and foundation of the postage stamp rate regime. Union contended that this conclusion was supported by past practice of franchise renewals.

- 3.3.15 Kingston contended that whatever “expectations” Union’s investors have, they are not based on any analysis of the franchise agreements or the law applicable to their renewal, and that the consequences of their expectations ought not to be visited upon Kingston, or to serve to motivate a tortured interpretation of the statutory regime.
- 3.3.16 Kingston’s position was that the pattern of renewals in other municipalities cannot create a contractual right between Union and Kingston. Kingston argued that if this matter is as fundamental and threatening to its business as Union now claims, then Union could have guarded against the risk of non-renewal by negotiating an appropriate renewal term with the municipalities.
- 3.3.17 Kingston indicated that the 1977 Franchise Agreement protected Union in that it afforded Union the right to sell its assets to any person in the event that the municipality did not wish to renew and the Board did not order a renewal. Thus, the City contended that Union clearly recognized and adverted to the risk that the Board could refuse to extend or renew its right to operate.

Rates

- 3.3.18 Kingston’s evidence was that its residential gas utility rates are lower than Union’s. Assuming that Kingston applied its current rates to Pittsburgh residents, the City contended that 99.9% of Pittsburgh residents would benefit from a rate decrease. Only two industrial customers would experience an increase.
- 3.3.19 Union stated that if Kingston operated a gas distribution system in Pittsburgh it would have to pay a transmission rate to Union to transport gas through Union’s transmission line to Pittsburgh, under Rate 77, thus narrowing or eliminating Kingston’s purported rate advantages. Alternatively, Kingston would have to build its own transmission line at an estimated cost of approximately \$525,000. Union contended that if Kingston operated the system in Pittsburgh an annual revenue deficiency would occur and that it would be necessary for Kingston to raise rates.

Operation of the Gas Distribution System

- 3.3.20 Kingston has adopted a restructuring plan to address financial challenges confronting the provision of public utility services by Utilities Kingston. The City's view is that it will be most convenient for residential, commercial and industrial customers to be able to access one supplier of natural gas, electricity, sewer and water services. Kingston's position was that Utilities Kingston can offer equally reliable service, at better rates than Union, to all residents of Kingston, with the result that all residents are treated equally and benefit to an optimal extent from convergence of services.
- 3.3.21 As part of its evidence Kingston filed survey results which indicated that the residents of Pittsburgh are in favour of Kingston's convergence plan.
- 3.3.22 Union countered that it had been providing reliable gas service for 40 years and that Union would provide superior service to that of Kingston.
- 3.3.23 Kingston submitted that there was no evidence to indicate that Union had more reliable service, safer operations or a greater range of services than Kingston.

Ownership of the Assets

- 3.3.24 Union pointed out that it is the only party who currently owns facilities to distribute gas in the former Township of Pittsburgh. The only alternative proposed, namely Kingston's proposal that the Board impose a lease or service agreement on Union such that Kingston operate Union's pipeline in the former Township of Pittsburgh, is unfeasible since, among other reasons, the Board has no authority to impose such an order.
- 3.3.25 Union also noted that the fact that the municipality is the legal owner of public lands on which the distribution system is built does not entitle the City to any special right to object to or prohibit a utility from using the land. Public lands do not belong to a municipality in the same way as lands belong to a private owner. A municipality holds lands in trust for the public, and a municipality is required by law to allow those lands to be used for the furtherance of the public interest.

Business Case

3.3.26 Kingston presented a business case, for purposes of illustration, to the Board that was based on assumptions and payments designed to keep Union whole in respect of the rate-making value of its gas assets in Pittsburgh. This case suggested Kingston could generate profits on a 5-year, 10-year and *a fortiori*, longer term horizon. Kingston pointed out that Union considers that 40 years is an appropriate horizon to assess the feasibility of system expansion.

3.3.27 Kingston stated that it has no intention of providing service to Pittsburgh if the terms imposed by the Board are prohibitive and not in the interests of all Kingston residents. i.e. that there is no business case for doing so. Any order that terminated the franchise would be evaluated by Kingston carefully. If the costs were not acceptable, then Kingston has stated that it would renew the franchise with Union to ensure that Pittsburgh will continue to be served.

Other Considerations

3.3.28 Union argued that a refusal by the Board to renew the franchise would have several negative repercussions including: the end of postage stamp rates; increased debt costs and investor uncertainty, since the risk of franchise termination had not been factored into the determination of its allowed rate of return; the elimination of private sector profit; and loss of tax revenue to other levels of government.

Public Policy

3.3.29 The Consumers' Gas Company Ltd. ("Enbridge") limited its submissions to the broad public interest. Enbridge stated that the advantages of a system with a small number of natural gas distributors are stability, economies of scale, risk spreading, uniformity and consistency of customer treatment and regulatory facilitation. Moreover, Enbridge alleged that any Board decision that supports the concept of breaking up the status quo regarding gas distribution rights would be deleterious to the Province. Enbridge also submitted that Kingston's proposal implies that municipalities can break up distribution rights by refusing to renew franchises, even where there is no issue of

an incumbent distributor's performance and execution of its obligations. Enbridge argued that Kingston's proposal was focused on Kingston's interests alone, not on public convenience and necessity or the broader public interest. While Kingston and other municipalities could negotiate a purchase or joint partnership with current or prospective gas utilities, Kingston's proposal to acquire a private utility's assets and move it into the public sector is contrary to the intent of the *Energy Competition Act 1998*, S.O. 1998, c.15.

Precedent

- 3.3.30 Kingston submitted that much of Union's case depends on the premise that if the Board were to terminate the Pittsburgh franchise this would inevitably create a precedent which would have disastrous consequences. These would include increased costs of capital, the end of natural gas system expansion, and the abandonment of postage stamp rates. Kingston cautioned that the Board "must be very wary of these apocalyptic predictions".
- 3.3.31 In this regard, Kingston submitted that its circumstances are unique: it is one of only two municipalities in Ontario which provides natural gas service to its residents; Kingston's refusal to renew the Pittsburgh franchise is the result of the expansion of its territory mandated by the Ontario government; it desires to treat all of its residents equally; Kingston has almost 100 years of expertise in the provision of gas service in the municipality; it has demonstrated its expertise to the great satisfaction of its ratepayers; Kingston has demonstrated that it is as efficient as Union and can offer cheaper rates; and Kingston's initiatives toward convergence were undertaken prior to the amendments to the OEB Act.
- 3.3.32 Union argued that the uniqueness claimed by Kingston, such as its historical experience in operations, could be effectively replicated elsewhere by hiring a gas distribution system operator to run the system on the municipality's behalf. A decision in favour of Kingston would lead to other municipalities following Kingston's example, leading to a possible disintegration of the integrated gas distribution network in the province.

3.3.33 Kingston submitted that there is nothing more than anecdotal evidence that any municipalities are contemplating not renewing franchises, except for the City of Sudbury, whose situation is fundamentally different from the situation in Kingston. Kingston pointed out that, apart from Enbridge, no other individual, company or interest group made representations to the Board on behalf of the broader public interest.

3.4 TERMS AND CONDITIONS

3.4.1 In addition to the issues of public convenience and necessity set out above, in considering an application under section 10 of the MFA the Board must also consider the specific proposals regarding the terms and conditions of franchise renewal suggested by the parties and the extent of the Board's jurisdiction to impose terms and conditions.

Terms and Conditions Requested by Kingston

3.4.2 The City argued that section 10 of the MFA must, explicitly or by necessary implication, vest in the Board the power to transfer the operation of the works to another person. Were this not the case, every refusal to impose a renewal under section 10 would leave municipal ratepayers without service. Hence, whatever the precise circumstances that justify the termination of a franchise, the Board must have the power to bring about this termination in a fashion that is in the public interest. The City contended that termination of a franchise is sanctioned by the opening words of subsection 10(2) of the MFA which provides that the Board "has and may exercise jurisdiction and power necessary for the purposes of this section".

3.4.3 The City argued that if the Board can order that a franchise is terminated it must necessarily follow that it can order the transfer of the operation of the franchisee's assets to a third party. Whether such transfer is called an extension of an existing franchise with a Board order that the franchisee permit another party to operate the works on its behalf, or whether the Board actually orders that the franchise is not renewed, subject to terms and conditions that ensure an orderly wind-down, is immaterial.

- 3.4.4 The City submitted that under its proposal Union would receive payments which would compensate it fully for the rate-making value of its assets and any remaining operating and maintenance costs, including those that might be associated with the continued operation of the Barriefield Lateral transmission line. However, Union would not be compensated for any growth that might have occurred had the franchise been renewed. The City's position was that this approach was reasonable since that growth was entirely contingent on the renewal of the franchise, in respect of which the City claimed Union had neither a contractual nor a statutory right.
- 3.4.5 Union stated that it had no intention of selling its gas distribution assets in the former Township of Pittsburgh. In this respect Union noted the Province's policy, as expressed by the Minister of Energy, Science and Technology, that sales of utilities must be between willing buyers and sellers. Union has stated clearly to the City that it is not a willing seller and its assets are not for sale.
- 3.4.6 Union submitted that the Board does not have jurisdiction to impose the terms and conditions sought by Kingston. In Union's view there are only two ways in which a potential new gas distributor could develop distribution capacity in Pittsburgh: either build an entirely new distribution system or negotiate the purchase of Union's system on terms agreeable to Union.
- 3.4.7 Union argued that from an economic perspective, construction of a second set of facilities would increase distribution rates for Union's other customers, would be manifestly unfair to Union's investors, and would create a substantial disincentive for future expansion of gas service in the Province.
- 3.4.8 Union estimated the net book value of its rate base assets in the former Township of Pittsburgh at \$4.7 million. It also estimated the market value as \$7.2 million based on a discounted cash flow analysis. Using the formula set out in the repealed subsection 62(2) of the PUA the value was estimated by Union as \$6.85 million.

- 3.4.9 Union claimed that Kingston’s proposal is a thinly disguised attempt to circumvent the repeal of section 62 of the PUA and is in fact an expropriation which would deny Union the use of its property. Under Kingston’s proposal, the City would be allowed to remove and replace Union’s distribution system and payments to Union would end as soon as the City had replaced all of Union’s assets with its own. In Union’s view, the fact that the expropriation occurs gradually over a period of time does not change its character.

Terms and Conditions Requested by Union

- 3.4.10 At the hearing the issue was raised as to whether the Board has jurisdiction to impose the full terms of the model franchise agreement on the parties or whether the Board is limited to granting Union the right only to continue to “operate” the works.
- 3.4.11 Union’s position is that the Board has the power to renew Union’s rights specifically to extend or add to its works in the former Township of Pittsburgh. In Union’s view, renewing the right to operate the works effectively renews the right to extend or add to the works as well. Adding or extending to already existing works is inherent in the right to operate. A more restrictive interpretation of “operate” would be inconsistent with the purposes of the legislation, resulting in absurd consequences and depriving new customers of gas service during a renewal period where a restrictive interpretation precluded extensions.
- 3.4.12 Union argued that one of the objectives of section 10 of the MFA is to protect gas customers who might be deprived of gas service in the event that a municipality and utility company could not agree on the terms of a franchise renewal. In order for the Board to be able to protect the interests of all the residents of a municipality, the Board must necessarily have jurisdiction to authorize the expansion of the utility’s gas distribution system to serve new customers in the municipality. Union also argued that a narrow interpretation of section 10 of the MFA would not be consistent with the objectives of the OEB Act and would lead to arbitrary and inequitable consequences.

- 3.4.13 Union stated that it is a principle of statutory interpretation that the Legislature does not intend to produce absurd consequences, and interpretations which lead to unreasonable results are to be avoided. In order to operate gas works to properly serve the residents of a community, a utility must be able to maintain and replace those works as needed. Therefore the right to “operate works” must inherently include permission to maintain and replace those works. Public convenience and necessity also requires that the right to operate inherently includes permission to add to and extend the already existing works to serve new customers.

4. BOARD FINDINGS

4.0.1 The Board's jurisdiction under section 10 of the MFA is limited to two options: if public convenience and necessity appear to require it, the Board can renew or extend the term of the franchisee's right; or if public convenience and necessity do not appear to require it, the Board can refuse the extension of the right to operate the distribution works. On its face, section 10 indicates no preference for renewal or termination; the sole consideration is public convenience and necessity.

4.0.2 The Board finds that it has the sole jurisdiction to determine "public convenience and necessity" under section 10 of the MFA. This is supported by the decision in *Union Gas Limited v. Township of Dawn*, (1977), 76 D.L.R. 613 that provided at page 622:

In my view this statute makes it crystal clear that all matters relating to or incidental to the production, distribution, transmission or storage of natural gas, including the setting of rates, location of lines and appurtenance, expropriation of lines and appurtenances, expropriation of necessary lands and easements, are under the exclusive jurisdiction of the Ontario Energy Board and are not subject to legislative authority by municipal councils under the *Planning Act*..

- 4.0.3 In determining “public convenience and necessity” the Board is guided by the objectives of the OEB Act relating to the rational development of the supply, distribution and transmission of natural gas, including the maintenance of just and reasonable rates for the transmission, distribution and storage of gas and the facilitation of rational expansion of natural gas transmission and distribution systems.
- 4.0.4 In the Board’s view, “public interest” and “public convenience and necessity” are broader than local, parochial interests and the Board is required to consider matters affecting provincial gas distribution as a whole and not just local interests. In considering each individual application to renew or extend a franchise, the Board must balance the specific interests of all direct stakeholders, including ratepayers, the municipality and the utility shareholder, against the broader public interest.
- 4.0.5 While the views of the municipality should be taken into account by the Board they are not determinative of the issue of determining where public convenience and necessity lies.
- 4.0.6 The fact that Union had a “reasonable expectation” that the franchise would be renewed is also not a relevant factor in the determination of public convenience and necessity. The mere fact that most franchises are renewed without dispute is not sufficient to justify an assumption of automatic renewal of the franchise.
- 4.0.7 The Board is also not convinced that, if it were to refuse to renew Union’s franchise agreement for the Township of Pittsburgh, the dire consequences predicted by Union, such as the end of postage stamp rates, loss of economies of scale, loss of expertise, reduction of expansion of gas distribution, increased cost and complexity of regulation and an increase in the utility’s risk and cost of capital, would in fact occur.
- 4.0.8 The Board agrees with Kingston that because of the City’s unique situation, the Board’s determination in this case should not be considered a precedent for other municipalities to follow.

- 4.0.9 Both Union and Kingston have a long history of operating gas distribution systems in a safe, reliable and efficient manner. The Board is confident that either party has the ability to operate a gas distribution system in the former Township of Pittsburgh.
- 4.0.10 However, the issue before the Board is whether public convenience and necessity require the Board to grant or deny Union's Application. In order to make a determination in this case, the Board must also consider the Board's jurisdiction to order the requested terms and conditions.
- 4.0.11 The Board is not convinced by the City's arguments that if the Board can terminate a franchise it must necessarily follow that it can transfer the operation of the assets to a third party. Any power to expropriate must be clear and unambiguous in the Board's governing legislation. This is not the case in this instance.
- 4.0.12 As noted by the Ontario Superior Court of Justice in *Re Corporation of the City of Sudbury and Union Gas Ltd.* (2000), 47 O.R. (3d) 654 ("*Sudbury v. Union*") at page 664, "The OEB has no jurisdiction to decide who is entitled to ownership of the gas distribution system".
- 4.0.13 Kingston's proposal is creative and attempts to characterize its proposed arrangement with Union as a lease or services agreement. However, the practical effect of the proposal is that the City would gradually take over ownership of Union's gas distribution assets in the former Township of Pittsburgh. The Board has no authority to do indirectly what it cannot do directly. The Board agrees with Union that it has no jurisdiction to expropriate Union's assets and the fact that the expropriation occurs gradually over a period of time does not change its character. The Board has no authority to make the order requested by Kingston.
- 4.0.14 In a number of previous cases, the Board has determined that it has jurisdiction to impose the terms of a franchise agreement in situations where the municipality and the gas distribution company cannot agree. The Divisional Court in *Re City of Peterborough and Consumers Gas* (1980), 111 D.L.R.. (3d) 234 upheld the Board's jurisdiction to impose the terms of the franchise in situations where the municipality and the gas distribution company cannot agree on the terms.

4.0.15 The opening words of subsection 10(1) of the MFA provide that “where the term of a right **to operate** works for the distribution of gas has or will expire within one year” (emphasis added). In other words, the expiration of the right to operate the gas distribution works is a triggering event and is a condition precedent to an application by the municipality or the utility under section 10(1) of the MFA.

4.0.16 In *Sudbury v. Union* the Ontario Superior Court of Justice recognized at page 664 that:

The OEB has exclusive jurisdiction to determine who is entitled to operate the Sudbury gas system.

4.0.17 The Court, however, noted at page 660 of the decision that this jurisdiction to determine who has the right to operate the gas distribution system is not unlimited:

The power of the Board to extend the term of a franchise under section 10 of the *Municipal Franchises Act* is limited. There is no power in the OEB to grant a franchise to another party over the objection of a municipality. There is only the power to renew or extend an existing franchise, and then only if ‘public convenience and necessity appear to require it’.

4.0.18 In the Board’s view the right to operate and the ancillary rights necessary to accomplish this include the ability to add to and extend the gas system, as provided for in the model franchise agreement.

4.0.19 The Court in *Sudbury v. Union* pointed out at page 660 of the decision that the Board has powers to impose terms and conditions and stated:

However, where the appropriate circumstances exist for the exercise of the OEB’s jurisdiction to renew or extend the term of operating rights, the Board also has an ancillary jurisdiction under s.10(2) to impose “terms and conditions” on the renewal or extension. The

OEB's jurisdiction under this provision is not restricted by who has ownership of the gasworks.

and at page 667:

Under s.10 of that Act [the MFA] the OEB can only order an extension or renewal of the right to operate the gas distribution system (**along with any ancillary rights necessary to accomplish that end**). (emphasis added)

- 4.0.20 Prior to 1988 franchise agreements between municipalities and utilities were negotiated on an individual basis. In November 1985, the Board held a generic hearing, E.B.O.125, to consider and provide the Board's guidance on issues frequently arising from franchise agreements. As a result of the Board's determination in E.B.O.125, a model franchise agreement was developed. This model agreement has formed a template for most new and renewed franchises.
- 4.0.21 The Board has recently received submissions and heard presentations from municipalities and utilities on proposed amendments to the model franchise agreement. As a result, the Board is in the process of approving and issuing a new form of model franchise agreement (the "2000 Model Franchise Agreement").
- 4.0.22 The Board notes that the City of Kingston is not disputing the particular terms of the franchise agreement proposed by Union; rather it is stating that the Board should not impose a franchise agreement at all. The City has stated that it would be willing to agree to the terms of the model franchise agreement proposed by Union if the City determines that it does not want to proceed with its proposal to take over the operation of Union's gas distribution assets in the Township of Pittsburgh. Union has also indicated that it would be amenable to the Board imposing the terms and conditions of the 2000 Model Franchise Agreement.

- 4.0.23 The Board finds that it does not have the jurisdiction to impose the order requested by Kingston. Therefore, in order to ensure that residents of Pittsburgh continue to receive natural gas distribution services, the Board finds that public convenience and necessity appear to require that the Board renew or extend the term of the right of Union to operate works for the distribution of gas in the City of Kingston in the area comprised of the former Township of Pittsburgh.
- 4.0.24 Once the 2000 Model Franchise Agreement has been approved and issued by the Board, the Board will issue an order renewing the right of Union to operate works for the distribution of gas in in the geographic area of the City of Kingston that was formerly the Township of Pittsburgh for the period and on the terms and conditions set out in the 2000 Model Franchise Agreement.
- 4.0.25 In the interim, the Board orders that the right to operate works for the distribution of gas and to supply gas, conferred by the franchise agreement between Union Gas Limited (the successor of Centra Gas (Ontario) Inc. and Northern and Central Gas Corporation Limited) and the former Corporation of the Township of Pittsburgh, dated October 24, 1977, be continued until such time as the order referred to in paragraph 4.0.24 is issued by the Board or at the latest December 24, 2000.

5. ADDITIONAL MATTERS

5.0.1 A number of additional matters were raised at the hearing that the Board considers are important to comment on at this time.

5.1 CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY

5.1.1 The effect of the Restructuring Order on the requirement of the City to obtain a Certificate of Public Convenience and Necessity pursuant to section 8 of the MFA was raised at the hearing.

5.1.2 Subsection 8(1) of the MFA provides:

Despite any other provision in this Act or any other general or special Act, no person shall construct any works to supply

(a) natural gas in any municipality in which such person was not on the 1st day of April, 1933, supplying gas; or

(b) gas in any municipality in which such person was not on the 1st day of April, 1933, supplying gas and in which gas was then being supplied,

without the approval of the Ontario Energy Board,

and such approval shall not be given unless public convenience and necessity appear to require that such approval be given.

5.1.3 The old City was supplying gas prior to April 1, 1933 and therefore the Board has not issued Kingston a Certificate of Public Convenience and Necessity with respect to constructing works to supply natural gas.

5.1.4 Union argued that since the new City did not exist on April 1, 1933, it could not have been supplying gas on that date and therefore is not entitled to rely on the exemptions in paragraphs 8(1)(a) and (b) of the MFA.

5.1.5 While the creation of the new City has loosely been described as a municipal amalgamation, this is not legally accurate. Clause 3.1(a) of the Restructuring Order provides:

On January 1, 1998, The Corporation of the City of Kingston and the Corporations of the Townships of Pittsburgh and Kingston and their local boards are dissolved and a new city to be named The Corporation of the City of Kingston is incorporated.

Therefore the old City is not the same person as the new City.

5.1.6 However, as a result of the Restructuring Order, the new City still retains certain aspects of the status of the old City. Clause 7.3(a) of the Restructuring Order provides that:

All assets, liabilities, obligations and responsibilities of the Corporation of the City of Kingston and The Corporations of the Townships of Pittsburgh and Kingston and their local boards are transferred to the new Corporation of the City of Kingston on January 1, 1998, without compensation.

- 5.1.7 While the ability to supply gas without a Certificate of Public Convenience and Necessity is more properly characterized as a “right”, if the clause is given broad purposive reading, it is arguable that such ability may be characterized as an “asset” which has been transferred from the old City to the new City. This interpretation is supported by the general principle that a statute must be clear and unambiguous in taking away rights that have previously been enjoyed. This interpretation would be consistent with the Privy Council decision in *United Gas & Fuel Co. v. Dominion Natural Gas* [1934] 3.D.L.R. 529 (J.C.P.C.)
- 5.1.8 It is the Board’s view that, because of the uncertainty of the effect of the Restructuring Order, it would be prudent for the City to apply to the Board for a Certificate of Public Convenience and Necessity to construct works to supply natural gas within the boundaries of the old City.
- 5.1.9 The Board is sympathetic to Kingston’s desire to be able to offer gas services to all of its residents, both old and new. The Board is confident that Kingston has the ability to provide safe, reliable, gas distribution services throughout the new City as it has provided in the past in the old City.
- 5.1.10 The Board notes that the franchise granted to Union is not exclusive. Since the original grant of the right to distribute natural gas is vested in the municipality, subject to obtaining a Certificate of Public Convenience and Necessity, Kingston also has the right to construct works in the former Townships of Pittsburgh and Kingston.
- 5.1.11 If Kingston wishes to expand its facilities in areas of the City that were formerly in the Townships of Pittsburgh or Kingston, the City should apply to the Board for Certificates of Public Convenience and Necessity at that time.

5.2 RATE 77

5.2.1 During the proceeding, both Union and Kingston assumed that if Kingston were to receive natural gas from the Barriefield lateral, Kingston would pay Union for such transmission service under Rate 77. The Board is of the view that this may not be the applicable rate.

5.2.2 If Kingston decides to expand its works to provide service to customers in the former Township of Pittsburgh, the Board will address issue of the appropriate rate for the use of transmission services, if required, at that time.

6. COSTS

6.0.1 The Board's costs shall be paid by the Company upon receipt of the Board's invoice.

DATED at Toronto June , 2000

Sheila K. Halladay
Presiding Member

Roger M. R. Higgin
Member

A. Catherina Spoel
Member