500 Consumers Road
North York, Ontario
M2J 1P8
PO Box 650
Scarborough ON M1K 5E3

Lesley Austin
Regulatory Coordinator
Regulatory Proceedings
phone: (416) 495-6505
email : lesley.austin@enbridge.com

VIA RESS, EMAIL AND COURIER

June 3, 2009

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

Re: Consultation on Transition to International Financial Reporting Standards Enbridge Gas Distribution Inc. ("Enbridge") – Reply Submission Board File No.: EB-2008-0408

Pursuant to the Board's May 14, 2009 letter in the above noted proceeding, and having filed a written submission on May 25, 2009, please find attached Enbridge's reply submission.

Further to the Board's direction, Enbridge has made this submission using the RESS and has sent 2 hard copies to the Board via courier.

Sincerely,

Lesley Austin
Regulatory Coordinator

cc: David Stevens, Aird & Berlis (via email)

EB-2008-0408

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act*, 1998, S.O. 1998, c. 15 (Sched. B)

AND IN THE MATTER OF a Consultation on Transition to International Financial Reporting Standards (IFRS) and Consequent Amendments to Regulatory Instruments

REPLY SUBMISSIONS OF ENBRIDGE GAS DISTRIBUTION INC.

1. The following are the comments of Enbridge Gas Distribution Inc. ("EGD", or the "Company") in response to the submissions of other stakeholders that were filed on May 25, 2009. EGD's comments are organized under the issue headings used in the Board Staff Proposal for Discussion (the "Board Staff Proposal").

2. Scope

(a) Contrary to the concern expressed by a number of parties[1], EGD is not seeking to have the Ontario Energy Board (the "OEB" or the "Board") address or consider the impact of the adoption of IFRS on utility risk profiles in this first phase of the Consultation on Transition to International Financial Reporting Standards ("IFRS") and Consequent Amendments to Regulatory Instruments (the "Consultation").

(b) That said, the adoption of IFRS could have an impact on financial costs and risks faced by utilities, if a future rate-making panel of the OEB decides that IFRS, or some variant, is the preferred methodology that it wishes to adopt for purposes of setting the rates of some or all of the utilities that it regulates. In this regard, the following outcomes could occur, in whole or in part:

[1] See, for example, the submissions of IGUA at p. 4, VECC at p. 1, CCC at p. 4 and CME at p. 5.

(i) increased cost pressures resulting from the creation and maintenance of multiple sets of financial record-keeping under different methodologies;

(ii) reduced earnings (because rate base may go down as items are re-classified from capital to operating expenses);

(iii) increased volatility of year-over-year revenues and earnings, if the use of deferral and variance accounts is reduced for regulatory purposes;

(iv) increased volatility of year-over-year revenues and earnings, if the use of deferral and variance accounts is not recognized or accepted for external financial reporting purposes;

(v) de-linking between the costs and revenues embedded in rates and returns during the Incentive Regulation mechanism ("IRM") term versus the costs and revenues being recognized during that same period under IFRS; and

(vi) variances between actual and forecast cost of debt requirements if two different models for items such as capitalization and depreciation are used for rate setting and financial reporting purposes; this will impact on equity investment, interest coverage and return levels.

(c) In this context, EGD submits that it may be necessary, at a later stage, for the Board to consider, and potentially make allowances for, changes to address the financial risks on regulated utilities resulting from the adoption of IFRS. As noted in EGD's May 25th submissions[2], it is likely that this will best be addressed in utility-specific applications dealing with rates, or with the impact of the adoption of IFRS.

3. <u>Timing</u>

(a) Stakeholders have expressed a range of views about what urgency there is for the Board to make final determinations about how it will adopt IFRS. All parties, including EGD, appear to agree, though, that direction from the Board is needed about certain key items such as the creation of deferral accounts or other means

[2] EGD's May 25th submissions, at paras. 12(c) and 14 (e).

to track ongoing IFRS transition and implementation costs, the continued use of deferral and variance accounts and the use of historic costs to set the opening rate base value for January 1, 2011.

(b) EGD has already described its recommended approach for how the Board may wish to proceed[3], and will not repeat it here. EGD does note, however, that all of the stakeholder positions in respect of timing can be accommodated, as long as the Board's Policy Report:

(i) is founded on solid principles;

(ii) is sufficiently flexible to accommodate changes to address information and impacts not yet known; and

(iii) acknowledges the likelihood and appropriateness of future proceedings (likely utility-specific) to address the impacts of the adoption of IFRS on regulated entities and their ratepayers.

4. <u>Issue #1 : Principles</u>

(a) In their discussion of the principles to be considered and applied by the Board (particularly the fifth principle in the Board Staff Proposal), several parties raise questions about what level of uniformity is necessary or appropriate in terms of how the Board will adopt IFRS for the entities that it regulates.[4]

(b) EGD acknowledges the Board's preference to develop an approach that could apply equally to all entities that it regulates. There may be cases, however, where a different approach to the adoption of IFRS for particular items is appropriate for different utilities, because of their particular circumstances. Examples might be in the rate-making treatment for asset retirement obligations ("AROs") or in the treatment of pensions and employee future benefit costs. It appears that Ontario utilities currently address each of these items in varying ways, and that requiring uniformity of treatment might result in negative financial

---

[3] EGD's May 25th submissions, at para. 14.

[4] See, for example, Hydro One at pp. 3-4, CCC at p. 5, SEC at p. 20.

consequences, including the imposition of costs on utilities and ratepayers that could otherwise be avoided.

(c) EGD proposes, therefore, that it remain open to a utility to justify to the Board as part of a utility-specific rate application that the Board's standard approach to the adoption of IFRS on a particular issue or item ought not to apply to that utility.[5]

5. Issue #2 Regulatory Assets and Liabilities

(a) Several parties submit that as part of its modified adoption of IFRS, which would endorse the continued use of deferral and variance accounts, the Board should provide enhanced definitions of the accounts[6], and provide more explicit assurances of recovery of amounts recorded in the accounts[7]. Others warn that the adoption of IFRS should not lead the Board to provide blanket assurance of the recoverability of amounts recorded in the accounts.[8]

(b) EGD submits that, at very least, there should be no less assurance of recovery of deferral and variance accounts, once IFRS is adopted. Thus, while amounts recorded in deferral and variance accounts will continue to be subject to a prudence review before clearance, expenditures recorded in these accounts will be deemed to be prudent, in the absence of some evidence suggesting the contrary.[9]

6. Issue #3 Property, Plant and Equipment (PP&E)

(a) All stakeholders appear to agree that regulated net book value should generally be used as the basis for setting opening rate base value at the time of IFRS adoption. Some stakeholders suggest, in addition, that where a utility chooses to

---

[5] EGD notes that this position is similar to that taken by SEC (at p. 20).

[6] CLD, at p. 2.

[7] CLD at p. 2 and Union at pp. 5-6.

[8] VECC, at p. 5

[9] This is the OEB's current approach. See, for example, the discussion in EGD's F2002 rate case : EB-2001-0032, at paras. 3.12.1 to 3.12.5; affirmed in *Enbridge Gas Distribution Inc.* v. *Ontario Energy Board*, 2005 CanLII 4941 (Ont. Div. Ct.), at paras. 9 and 10; and 2006 CanLII 10734 (Ont. C.A.), at paras. 8 to 11.

use a different approach to setting opening or ongoing rate base, in whole or in part, then the utility should be responsible for any transitional or ongoing costs that result.[10] EGD disagrees, and submits that there may be valid justifications for such an approach. There should be no predetermination of that issue. Instead, it should be open to utilities who choose to use a different approach to setting the value of opening or ongoing rate base, in whole or in part, to justify why ratepayers should be responsible for any transitional or ongoing costs that result.

(b) Stakeholders seem to agree that many of the current capitalization policies and approaches used by regulated utilities will require changes to conform with IFRS. It appears, though, that there is a range of opinion about whether the Board should immediately or automatically endorse these different capitalization policies or approaches once IFRS is adopted. The Company notes that the impacts from a change in capitalization policy could be material. In its May 25th submissions, EGD set out the potential earnings impact of such a decision, and noted potential impact on rate base, and consequently the capital structure of utilities that could also result.[11] In its submissions, SEC set out the ratepayer impact of such a decision.[12] Of course, these impacts will be different for many regulated utilities. EGD submits, therefore, that the Board's approach to the issue of capitalization policy under IFRS should explicitly provide that utilities and the Board will address the impacts of changes in capitalization policy (in terms of rates, earnings, capital structure, financial risk and related matters) in utility-specific proceedings at, around or after the time that IFRS is adopted.

(c) EGD agrees with the submissions made by Hydro One and CCC that the rate-making treatment for AROs should be determined on a case-by-case basis for each utility, rather than through a standardized approach.[13]

---

[10] See, for example, BOMA/LMPA at p. 7 and VECC at p. 5.

[11] EGD's May 25th submissions, at para. 21 and Appendix A.

[12] SEC, at p. 24.

[13] Hydro One at p. 3 and CCC at p. 8.

7. Issue #4 Depreciation

(a) EGD acknowledges that it may be necessary for utilities to obtain updated depreciation studies as of January 1, 2011, to comply with IFRS. In this regard, EGD agrees with the concern raised by BOMA/LMPA about the use of new depreciation rates midway through an IRM period, where the new depreciation rates are used for financial reporting purposes and the existing depreciation rates are used for regulatory and rate-making purposes. In that situation, there will be a divergence between the amounts collected in rates, and the amount that should have been collected in rates, and there will also be a disconnect between the regulatory value of assets and the balance sheet value of assets at the end of the IRM term (because different depreciation rates will have been applied to the same assets). As described in EGD's May 25th submissions[14], and below in respect of Issues #8 and 9, this issue may lead EGD to make application to the Board in 2011 to consider the impact of any updated depreciation study (and other IFRS-related changes), and thereby ensure there is no disconnect between the regulatory asset values and the IFRS asset values on rebasing.

8. Issue #5 Other Issues

(a) EGD continues to evaluate the implications of the Board Staff Proposal in respect of inventory valuation and the PGVA, and the different position taken by Union on this issue[15]. At this stage of its review, EGD is not yet able to provide a firm position on this issue. EGD expects to advise about how it intends to proceed in respect of valuation for gas inventory well in advance of the January 1, 2011 effective date for IFRS.

9. Issue #6 Decisions of Accounting Standard-Setting Bodies

(a) No comments.

[14] EGD's May 25th submissions, at paras. 22(d) and 25(a).

[15] Union, at pp. 10-11.

10. Issue #7 Rate Impact

(a) Numerous stakeholders endorse the Board Staff Proposal that any rate impacts of more than 10% resulting from the adoption of IFRS will necessarily trigger rate mitigation approaches.[16] Another stakeholder suggests that any rate impacts resulting from IFRS adoption should be subject to rate mitigation measures.[17] EGD does not agree that rate mitigation measures (which the Company understands to mean rate smoothing techniques) should automatically be used every time a pre-determined threshold is reached. Indeed, EGD does not believe that there is any benefit in establishing any threshold as a trigger. Instead, the question of whether rate smoothing is appropriate should be determined on a case by case basis in light of all the circumstances that apply to the utility in question.

11. Issue #8 Utility and Shareholder Impact

(a) Stakeholders appear to generally agree that a utility's reasonable costs of transitioning to IFRS should be recoverable in rates. Beyond that, however, a range of views are expressed in the submissions of ratepayer groups and utilities. In response to these submissions, EGD says the following:

(i) IFRS conversion is a compliance requirement faced by all regulated utilities and other entities. The cost drivers associated with conversion will be similar in nature for all utilities, regardless of the rate-making regime that applies to the entity. In that context, EGD submits that all utilities should be entitled to full recovery of their reasonably incurred costs for conversion, as well as the ongoing transition and administrative costs resulting from the adoption and switch over to IFRS reporting.

(ii) Those parties who began preparations for IFRS, and incurred related costs, earlier than others should not be penalized for doing so. All

---

[16] See, for example, CLD at p. 4, THESL at p. 14, CCC at p. 10, VECC at p. 12.

[17] IGUA, at p. 2.

regulated entities who have incurred costs prior to the Board's final ruling on this issue should be entitled to recovery of those costs.

(iii) Some parties advocate an approach whereby IFRS conversion and implementation costs would be collected in deferral accounts, but that the disposition of those accounts would not be considered until after the IFRS transition is completed.[18] EGD does not agree. There is no reason why such costs cannot be addressed on an annual basis, at the same time as a utility's other deferral and variance accounts are being considered and cleared.

(iv) One stakeholder advocates an approach whereby a standardized amount or allowance would be available for regulated entities to cover their conversion and implementation costs.[19] EGD does not believe that sufficient information currently exists to establish the amount of a standard allowance. In addition, EGD believes that the conversion costs for a large, privately-owned and publicly traded utility may be quite different from those of a small municipally-owned utility (even on a per-customer basis).

(v) The use of Z-factor considerations to determine what IFRS conversion and implementation costs should or should not be recoverable is not appropriate in this circumstance. Conversion to IFRS is a requirement for all regulated entities in Ontario, and all such entities should have the opportunity to recover their prudently incurred costs of conversion and implementation. The use of Z-factor tests unfairly penalizes some utilities over others. For example, there will be some utilities who are not subject to Z-factor tests during at least some of the years when costs are incurred (because they are in a rebasing year, or are subject to cost of service rate-making). The fact is that IFRS conversion costs will be incurred over a number of years, and the total costs for any utility will most likely

[18] See, for example, VECC at p. 12.

[19] SEC, at pp. 33 to 34.

exceed Z-factor thresholds. To disallow some costs to a utility because it falls short of the Z-factor threshold in a particular year, but still incurs substantial conversion and compliance costs over the course of several years, is not an evenhanded approach.

(vi) In any event, even if the Board does require utilities to meet any applicable Z-factor thresholds before permitting amounts to be recovered for IFRS conversion and implementation, it is appropriate that the Board permit all utilities to establish deferral accounts to track costs for future consideration and disposition. To require, as CME suggests[20], that a utility must first establish on a prospective basis that they will meet the Z-factor threshold before a deferral account is established is punitive. In addition, it will result in needless regulatory burden as utilities will have to deal with IFRS conversion and implementation costs twice each year (once to establish that the forecast costs exceed the Z-factor threshold and once to establish that the actual costs are recoverable).

(b) In response to Board Staff Issue 8.4, EGD believes that steps should be taken, as much as possible, to reduce the gap between the revenues actually collected in rates during an IRM term after IFRS is adopted versus the revenues that would be collected in rates if a utility was in a cost of service environment and could adopt IFRS immediately for rate-making purposes. If such steps are not taken, then there will likely be large amounts of money owed or owing at the end of the IRM term, through some sort of true-up exercise. To address this issue, EGD proposes that the ongoing impacts of the adoption of IFRS may have to be addressed during the IRM term, through utility rate applications. EGD believes that this could greatly reduce or eliminate the need for deferral accounts to track the differences between revenues under CGAAP and revenues under IFRS or modified IFRS. EGD's further comments on this topic are set out below in respect of Issue #9.

[20] CME, at p. 4.

12. Issue #9 Filing and Reporting Requirements

(a) In its May 25th submissions, EGD pointed to its preference for minimizing the number of years during which it must meet reporting requirements under three different accounting approaches (CGAAP, modified IFRS and IFRS). Having considered the submissions of other stakeholders alongside this concern, EGD sees the merit in the general approach suggested by Union to address this issue[21], at least from the perspective of large gas distribution utilities.

(b) Along the lines of what Union has suggested, EGD may apply, during the IRM term, to have the Board address the financial differences and any resulting revenue requirement impacts that arise from the adoption of the IFRS requirements specified by the OEB. The Board's decision in that regard would be incorporated into rates, business processes, systems and regulatory reporting on a go-forward basis. This approach would reduce the uncertainty that would otherwise exist if EGD were to wait until rebasing in 2013 to have the Board address the disposition of deferral accounts that had tracked the financial impacts of IFRS adoption, as well as the disconnect that would have developed between regulatory asset values and the IFRS asset values. EGD notes that this proposed approach is consistent with EGD's recommended approach set out at paragraph 12 of its May 25th submissions.

(c) Given EGD's proposal to deal with the rate-making and related impacts of the adoption of IFRS at or around the time of adoption, it does not believe that there is a need, as proposed by CCC[22], to establish a working group to explore the issues related to deferral and variance accounts established as a result of this proceeding. If, however, such a working group is established, EGD would seek to participate.

---

[21] Union's proposal is set out at pp. 13 and 15 of Union's submission.

[22] CCC, at p. 11.

(d) EGD does not believe that it is necessary, or logistically feasible, for the Board to establish a "standing panel" to deal with all accounting issues, as proposed by SEC.[23] For example, it may be that the accounting issues raised by parties as part of their rate proceedings are not easily removed from those broader proceedings to be dealt with separately by a different panel. EGD does agree, though, with SEC's suggestion that where accounting issues of general application are raised in a utility-specific application then it is appropriate that all interested parties get specific notice of the consideration of the issue, and be given the opportunity to participate in the determination of the issue.

13. Issue #10 Electricity Distributor and Gas Utility RRRs

(a) In its May 25th submission, EGD inadvertently failed to address Issue 10.5 of the Board Staff Proposal. The Company agrees with the position taken by the CLD on this Issue[24], namely that an additional third party audit of a utility's "modified IFRS" reported values, in addition to the audit of IFRS reported values is not necessary. EGD submits that the extra efforts and training of external audit resources and associated extra layer of costs (which ratepayers will ultimately bear) for two sets of audits because of modified IFRS reporting to the OEB are not justified. Utilities have regulatory accounting professionals who are able to translate audited external financial reporting into modified reporting for regulatory purposes. Utilities currently report aspects of their operations to the Board on a different basis from the way that operations are described in audited financial statements (for example, EGD has certain non-utility operations and regulatory concept calculations versus pure financial reporting calculations that are adjusted within the financial reporting provided to the OEB), and there is no current requirement for a separate audit of the values reported to the OEB.

---

[23] SEC, at p. 37.

[24] CLD, at p. 6.

14. EGD thanks the Board for the opportunity to respond to the submissions of other stakeholders. EGD welcomes any follow-up questions from Board Staff and the Board to address issues that arise from these reply submissions.

Date: June 3, 2009