

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

**AND IN THE MATTER OF** an Application by Enbridge Gas  
Distribution Inc. for an Order or Orders approving or fixing  
rates for the sale, distribution, transmission and storage of  
gas commencing January 1, 2010.

**ENBRIDGE GAS DISTRIBUTION INC.  
ARGUMENT IN CHIEF**

**RETURN ON EQUITY IN THE  
CALCULATION OF EARNINGS SHARING**

In Procedural Order No. 5, the Board determined that it would address the following issue by way of written submissions:

Does the calculation of the earnings sharing referred to in Section 10.1 of the IRM Settlement Agreement require the use of an ROE based on the Board's cost of capital policy in effect at the time the IRM Settlement Agreement was entered into, or the 2009 Cost of Capital Report, which is in effect at the time the earnings sharing calculation will be performed? (the "ROE Issue")

In Procedural Order No. 6, the Board directed Enbridge Gas Distribution Inc. (Enbridge) to file argument in chief on this issue by today's date.

**Background**

The Board-approved Settlement Agreement in EB-2007-0615 sets out the parameters of a five year Incentive Regulation (IR) plan for Enbridge. Section 10.1 of the Settlement Agreement contains provisions with respect to an Earnings Sharing Mechanism (ESM). In particular, section 10.1 states that an earnings sharing amount shall be calculated in the following manner:

- (i) if in any calendar year Enbridge's actual utility ROE, calculated on a weather normalized basis, is more than 100 basis points over the amount calculated annually by the application of the Board's ROE Formula in any year of the IR Plan, then the resultant amount shall

be shared equally (i.e., 50/50) between Enbridge and its ratepayers;

- (ii) for the purposes of the ESM, Enbridge shall calculate its earnings using the regulatory rules prescribed by the Board from time to time, and shall not make any material changes in accounting practices that have the effect of reducing utility earnings;
- (iii) all revenues that would otherwise be included in a cost of service application shall be included in revenues in the calculation of the earnings calculation and only those expenses (whether operating or capital) that would otherwise be allowable as deductions from earnings in a cost of service application, shall be included in the earnings calculation.<sup>1</sup>

The term “ROE Formula” used in section 10.1 refers back to wording used in section 2.4 of the EB-2007-0615 Settlement Agreement. In section 2.4 “the Board’s formula for setting the ROE” is mentioned and these words are followed parenthetically by the defining term “ROE Formula”.<sup>2</sup>

The Board’s formula for setting the ROE was addressed in the Report issued by the Board at the conclusion of the EB-2009-0084 proceeding. In that Report, the Board decided that it was necessary to reset the formula that had previously been used for determining ROE. Specifically, the Board stated as follows:

In order to ensure that on an ongoing basis changing economic and financial conditions are adequately and appropriately accommodated in the Board’s formulaic approach for determining a utility’s equity cost of capital, **the Board has determined that its current formula-based ROE approach needs to be reset and refined.**<sup>3</sup>

(Emphasis in original.)

The Board’s ROE Formula is described in Appendix B to its Report in EB-2009-0084. Section 10.1 of the EB-2007-0615 Settlement Agreement refers to an ESM calculation based on “the application of the Board’s ROE Formula in any year of the IR Plan”. For

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<sup>1</sup> Board-approved Settlement Agreement in EB-2007-0615 (“IRM Settlement Agreement”), at section 10.1 (pp. 26-27), filed in this proceeding as Ex. E-1-1.

<sup>2</sup> IR Settlement Agreement, at section 2.4 (p. 11).

<sup>3</sup> EB-2009-0084, Report of the Board on the Cost of Capital for Ontario’s Regulated Utilities, December 11, 2009 (“EB-2009-0084 Report”), at p. 32.

the reasons that follow, Enbridge submits that, under section 10.1, the Board's ROE Formula in the year 2010 is that set out in Appendix B to the EB-2009-0084 Report.

### **Submissions**

The IRM Settlement Agreement refers to the "Board's ROE Formula". There is only one "Board's ROE Formula". The fact that section 10.1 refers to "the Board's ROE Formula", rather than "the ROE Formula specified in the 1997 draft Guidelines", is a clear indication that the calculation should not be based on a past approach that is no longer "the Board's ROE Formula". The phrase used confirms that the Board determines the formula to be applied, and in no way dictates that the formula will not change or evolve.

Section 10.1 of the EB-2007-0615 Settlement Agreement does not contemplate the use of an ROE that is static or pre-determined at a particular value, nor does it contemplate an ESM calculation that remains static over the term of the Agreement. This is clear from many aspects of section 10.1, including the following:

- (1) paragraph (i) of section 10.1 (as set out above) refers to an amount that is to be calculated "annually" by the application of the Board's ROE Formula;
- (2) as already stated, paragraph (i) refers to the application of the Board's ROE Formula "in any year of the IR Plan";
- (3) paragraph (ii) of section 10.1 (set out above) refers to a calculation that uses the regulatory rules prescribed by the Board "from time to time"; and
- (4) the inputs that are used in a formulaic calculation of ROE (such as the Long Canada Bond forecast) are not static, but are variable depending on when the calculation is done.

Given that the ESM calculation is dynamic, rather than static, it is entirely inconsistent to interpret section 10.1 to mean that the ESM calculation will continue to use an ROE Formula that is no longer the "Board's ROE Formula".

The Board has determined that the ROE Formula that existed prior to the EB-2009-0084 Report does not meet the Fair Return Standard (FRS). In this regard, the Board stated the following in the Report:

The Board has been informed by the numerous approaches used by various participants to the consultation to determine whether the formula continues to produce results that meet the FRS. The sum of the elements supporting the Board's decision to reset and refine its formulaic ROE is independent of the recent financial crisis and whether or not the crisis has abated.<sup>4</sup>

It is noteworthy that, in the foregoing passage from the EB-2009-0084 Report, the Board said that it had decided to reset and refine "its formulaic ROE", which corresponds with the language in section 10.1 of the EB-2007-0615 Settlement Agreement referring to "the Board's ROE Formula".

Further, the EB-2009-0084 Report contains the following statement about the FRS:

The Board is of the view that each time a formulaic approach is used to calculate an allowed ROE; it must generate a number that meets the FRS, as determined by the Board using its experience and judgment.<sup>5</sup>

Under section 10.1 of the EB-2007-0615 Settlement Agreement, an ROE calculation is done annually using a formulaic approach. The EB-2009-0084 Report says that this calculation must generate a number that meets the FRS<sup>6</sup>; the Report also indicates that the previously existing formula does not generate results that meet the FRS<sup>7</sup>. In short, it is not reasonable to interpret the words of section 10.1 to mean that the annual ESM calculation should continue to use a particular formulaic approach after the Board has decided that the particular approach does not meet the FRS.

Other Canadian regulators in addition to the Ontario Energy Board have determined that the results of the previously existing formula do not meet the FRS. The same conclusion has been reached by the National Energy Board<sup>8</sup>, the Alberta Utilities Commission<sup>9</sup> and the British Columbia Utilities Commission.<sup>10</sup> It would lead to an absurd and unfair result if the reference to "the Board's ROE Formula" in section 10.1 of

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<sup>4</sup> EB-2009-0084 Report, at p. 34.

<sup>5</sup> EB-2009-0084 Report, at p. 31.

<sup>6</sup> EB-2009-0084 Report, at p. 31.

<sup>7</sup> EB-2009-0084 Report, at pp. i and 32-33.

<sup>8</sup> Trans Quebec & Maritimes Pipelines Inc., RH-1-2008 (NEB), Reasons for Decision re Cost of Capital dated March 2009.

<sup>9</sup> Decision 2009-216, 2009 Generic Cost of Capital decision, dated November 12, 2009 (AUC).

<sup>10</sup> Order G-158-09, In the matter of Terasen Gas Inc. et al – Return on Equity and Capital Structure, Decision dated December 16, 2009 (BCUC).

the EB-2007-0615 Settlement Agreement were to be interpreted so as to require the ongoing use of a formula that is no longer the Board's formula and has been widely rejected as one that does not meet the FRS.

Enbridge submits further that the wording of paragraph (ii) of section 10.1 (set out above) makes it clear that the intention is to determine the ESM calculation to take account of the Board's ongoing and continually changing regulatory practices. Paragraph (ii) says that the ESM calculation shall use the regulatory rules "prescribed by the Board from time to time". The EB-2009-0084 Report sets out "refinements to the Board's policies with regard to the cost of capital"<sup>11</sup>, which, in essence, are the current "regulatory rules" in respect of ROE. The ESM calculation uses up-to-date inputs, which are based on current economic circumstances, and it uses the Board's current "regulatory rules". Another element in the ESM calculation is "actual utility ROE", which, among other things, reflects current economic circumstances. The Board specifically stated in the EB-2009-0084 Report that the earlier formulaic approach needed to be reset in order to ensure that, on an ongoing basis, changing economic and financial conditions would be adequately and appropriately accommodated.<sup>12</sup> It is inconsistent and illogical to interpret section 10.1 to mean that the ESM calculation must be updated for current inputs and current regulatory rules, but not the current ROE Formula.

## **Conclusion**

The Company's position on this issue is based upon a straightforward reading of section 10.1 of the IRM Settlement Agreement. The phrase "the Board's ROE Formula" is not static. The Settlement Agreement specifically directs the Company to calculate earnings for the purposes of the ESM on the basis of regulatory rules prescribed by the Board as they exist from time to time. The rules that govern the Board's ROE formula have been reset and recalibrated by the Board. Therefore, to measure earnings for the purposes of earnings sharing against any other value uses a benchmark that does not meet the FRS.

The answer to the "ROE Issue" in this proceeding is that the calculation of the earnings sharing referred to in Section 10.1 of the IRM Settlement Agreement requires the use of an ROE based on the Board's 2009 Cost of Capital Report. As noted in the wording of the ROE issue, it is that approach to ROE "which is in effect at the time the earnings sharing calculation will be performed".

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<sup>11</sup> EB-2009-0084 Report, at p. i.

<sup>12</sup> EB-2009-0084 Report, at p. 34 and Appendix B.

**All of which is respectfully submitted this 22<sup>nd</sup> day of February 2010**

A handwritten signature in cursive script, appearing to read "Fred D. Cass".

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Fred D. Cass, Aird & Berlis LLP  
Counsel to Enbridge

A handwritten signature in cursive script, appearing to read "David Stevens".

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David Stevens, Aird & Berlis LLP  
Counsel to Enbridge