IN THE MATTER OF the *Ontario Energy Board Act, 1998*;

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

ISSUE 17: RETURN ON EQUITY IN THE CALCULATION OF EARNINGS SHARING

Argument of Industrial Gas Users Association (IGUA)

Position Summary

1. The calculation of earnings sharing referred to in Section 10.1 of the IRM Settlement Agreement requires the use of an ROE based on the Board's cost of capital policy in effect at the time of the IRM Settlement Agreement.

2. This is dictated by both a fair reading Settlement Agreement itself, and by direction of the Board's updated Cost of Capital Policy (EB-2009-0084 *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* - the "2009 Report").

The Settlement Agreement

3. Section 10.1 of the Settlement Agreement must be read in the context of the carefully crafted agreement as a whole.

4. The basic premise of the Settlement Agreement's treatment of ROE is that the ROE in effect at the time of the settlement agreement is embedded in rates, with a "right to apply" off ramp provided in the event that the Board changes its ROE policy during the IRM term.

5. The "right to apply" concept is defined at section 6.1 of the Settlement Agreement. Section 6.1 addresses various z-factors, including changes to the Board's ROE methodology. This section provides that if the Board changes its ROE methodology, then

"Enbridge or any other Party...may apply for determination of whether or not that change should be applied to Enbridge during the term of the IR Plan".

6. The "changes" that may be attendant on a change in the Board's ROE methodology are not limited on the face of section 6.1 to changes to annual IRM formula calculated rates. Section 6.1 provides that the issue that would be the subject of an application to the Board is whether the change in ROE methodology should be applied *"to Enbridge"*.

7. The parties to the Settlement Agreement expressly agreed that upon an application to apply ROE changes to Enbridge Gas Distribution (EGD) during the term of the IRM plan, any party would be entitled to take any position. Section 6.1 expressly contemplates that such positions could include opposing the application of the change in the methodology *"to Enbridge"* (not merely to EGD's IRM formula derived rates) during the plan period, and/or proposing offsetting or complimentary adjustments to rates *"or revenues"*.

8. IGUA submits that this comprehensive language regarding how the parties agreed to address any changes to the Board's ROE methodology during the IRM term makes clear that, absent such application and a resulting order of the Board, no change would apply to any aspect of the Settlement Agreement.

9. In any event, any earnings shared with the company following conclusion of the test year in question are revenues collected from ratepayers, and, combined with the revenues collected through the year in the IRM determined rates, constitute the effective rates charged by the utility. That is, even on a narrow reading of the "right to apply" provision to apply only to the IRM determined rates, IGUA submits that the revenues shared pursuant to section 10.1 of the Settlement Agreement must, in fairness, be considered as part and parcel of effective utility rates. (IGUA maintains, however, that such a narrow reading is neither necessary nor appropriate, and for the reasons above submits that the "right to apply" is the mechanism agreed to by the parties in respect of any IRM changes as a result of the Board changing its ROE methodology.)

10. IGUA further notes section 2.4 of the Settlement Agreement. Section 2.4 of the Settlement Agreement reads as follows:

> ***2.4 Should the gas utilities ROE be adjusted in each year of the incentive regulation (IR) plan using the Board's approved ROE guidelines?***
>
> ***Complete Settlement:*** *The Parties agree that, except as otherwise provided in this Agreement, the percentage rate of return on equity ("ROE") of 8.39% that is already included in the Company's rates for 2007 will not be adjusted under the Board's formula for setting the ROE ("ROE Formula") during the term of the IR Plan.*

11. EGD submits in its issue 17 argument that the term "ROE Formula" as the term is defined in this section 2.4, and then used again in section 10.1 which addresses earnings sharing, references the Board's formula for setting the ROE, which means the Board's formula "from time to time", rather than the Board's formula as set out in the Board's 1997 draft guidelines (the 1997 Policy).

12. IGUA notes that the term "ROE Formula" as used in section 2.4 is used in specific reference to the 8.39% ROE that is already included in the Company's rates, and determined in accord with the 1997 Policy.

13. EGD also argues that there is only one "ROE formula", and that the Board's 2009 Report merely "reset and refined" that formula. The result, EGD argues, is that there is no "new" ROE formula, and there is only one ROE formula, as reset and refined, which is to be applied for ESM calculations going forward. EGD supports this argument on the basis that an ROE formula such as that applied by the Board is not meant to be static, and implicitly argues that resetting the equity risk premium component of the ROE formula is akin to updating any other input, as is required by the formula to determine the ROE to be applied at any point in time.

14. IGUA disagrees with this characterization. Changing the equity risk premium in an ROE formula is something entirely different from annual changes in the value of the non-static inputs as pre-defined in the initial formula. Changing the equity risk premium is akin to changing a term or a coefficient in the formula, and not merely adopting a pre-defined, but non-static, variable.

15. In any event, the Board's 2009 Report adds an additional variable to the calculation of ROE.

16. Contrary to EGD's submission, the 2009 Report clearly changes the formula itself. The ROE formula in the 2009 Report is thus a different formula from that in the 1997 Policy. As indicated in the way that the Board has framed issue 17, a choice between the two for purposes of earnings sharing determination must be made.

17. EGD also relies on subparagraph (ii) of section 10.1 of the Settlement Agreement, and in particular on the requirement that, for the purpose of the ESM, EGD is to calculate its earnings *"using the regulatory rules prescribed by the Board, from time to time..."*.

18. The rest of the operative phrase reads: *"...and shall not make any material changes in accounting practices that have the effect of reducing utility earnings."*

19. The intent of this provision is to ensure that no accounting convention changes are made that would have the effect of reducing utility earnings. This intent is elaborated on in subparagraph (iii) of the same section. Subparagraph (iii) provides further enumeration of the mischief aimed at by subparagraph (ii).

20. Section 10.1 of the Settlement Agreement must be read in the context of the settlement regarding ROE treatment during the IRM term enshrined in sections 2.4 and 6.1 of the Settlement Agreement, as reviewed above. Particularly when read in this context, the narrow intent of subparagraphs (ii) and (iii) of section 10.1 - i.e. that no accounting conventions will be changed to effect the earnings calculation - is clear.

21. In the event that the intentions of the parties for treatment of changes in ROE during the IRM term is not readily apparent on the face of the Settlement Agreement, as outlined above, the ADR generated documents that IGUA and others seek through a motion filed with the Board to introduce definitively illustrate the intentions of the parties (including EGD) that the Settlement Agreement be read and applied so as to require an application to change the ROE formula for earnings sharing purposes, rather than automatically applying any such change.

The 2009 ROE Policy

22. The Board's 2009 Policy expressly provides that it will come in to effect for the setting of rates beginning in 2010 by way of a cost of service application (page 61, top).

23. EGD's ESM application for 2010, to be filed in early 2011, is not a cost of service application. It is an application based on a mechanical calculation based on actual earnings.

24. As argued above, the ESM mechanism is part and parcel of the IRM Plan. It is an integral part of that plan, from the perspectives of both ratepayers and the company. The ESM mechanism is essentially a component of the formula for determining the ultimate revenues and return, in any year of the IRM Plan, for the utility.

25. Fundamentally changing the ROE to be used for ESM purposes (that is, changing the formula and base itself, rather than just plugging in pre-contemplated variances in pre-specified inputs) is tantamount to changing base rates during the IRM term. That may be done by way of an off-ramp (which is why the "right to apply" concept is addressed under the z-factor discussion in the IRM Settlement Agreement), but not otherwise.

26. IGUA submits that this is precisely why the Board, in its 2009 Policy, was very specific about implementation of the new policy upon cost of service rebasing.

A "Fair Return Standard"

27. Much of EGD's argument on issue 17 complains that adoption of the 2009 Report for the purposes of determining its ultimate (after earnings sharing) ROE is essential in order to meet a "fair return standard".

28. Such an argument has no merit in the context of a comprehensive and carefully negotiated IRM plan.

29. The Settlement Agreement defining EGD's IRM plan is a package deal (Settlement Agreement, page 5, second last paragraph *et seq.*). The comprehensive IRM framework enshrined in the Settlement Agreement was negotiated by parties over many months and

in great detail. The settlement process included compromises made by all parties to achieve a consensus on settlement. From the perspective of the parties, "fairness", measured against the objectives that the parties to the settlement identified as appropriate for an IRM plan, is achieved as a result of these compromises (bottom of page 6 and top of page 7).

30. IRM is intended to provide incentive for a utility to earn more by reducing costs. In exchange for the entitlement to earn more, the utility under IRM accepts risks, as defined by the agreement.

31. EGD accepted the ROE formula embedded in 2007 rates as part of its IRM plan, with the right to share in any excess earnings and thus boost its ROE.

32. In 2008 EGD in fact earned over 10% after earnings sharing in accord with the ROE determined through application of the 1997 Policy. (Union earned around 13% after 2008 earnings sharing.)

33. The simple point is that earnings during an IRM term will vary around the ROE embedded in rates. It is the terms of the IRM Settlement that provide the utility with the opportunity to earn a fair return.

34. In this instance, EGD's rights go even further. EGD has the express right to apply to the Board, if it asserts that it is not earning a fair return, to determine whether the Board's 2009 Policy should be applied to EGD during the term of its IRM plan.

35. Importantly, the rights of the other parties to the IRM Settlement Agreement are balanced against this right of EGD to apply for a change in ROE. In recognition that the Settlement Agreement is a carefully balanced accord, with "puts and takes" on all sides, the agreement provides that in the event that EGD applies for a change in ROE approach during the term of the agreement, IGUA and others are free to argue about the implications of any such change to the balance of the components of the carefully crafted IRM Settlement Agreement.

36. The issue for determination at this stage is not whether the "fair return standard" requires application of the 2009 Report to determination of ROE during the IRM term. The issue is whether the ROE determined in accord with the 2009 Report applies automatically, "as of right".

37. IGUA submits that the new ROE policy should not automatically apply, and that, as illustrated above, the Settlement Agreement and the entire IRM settlement framework considered makes it clear that it does not.

ALL OF WHICH IS RESPECTFULLY SUBMITTED:
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