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August 20, 2010

VIA RESS, EMAIL AND COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
Suite 2700
Toronto, Ontario,
M4P 1E4

Dear Ms. Walli:

Re: Enbridge Gas Distribution Inc. ("Enbridge")
2009 Earnings Sharing Mechanism and Other Deferral
And Variance Accounts Clearance Review
Ontario Energy Board ("Board") File No. EB-2010-0042

Pursuant to the Board's Procedural Order No. 2 dated July 8, 2010, enclosed please find two paper copies of the Argument-in-Chief on the Stock-Based Compensation ("SBC") Issue.

The above document has been filed through the Board's RESS and will be available on our website at www.enbridgegas.com/ratecase August 21, 2010.

Sincerely,

L Chiasson

Lorraine Chiasson

encl.

cc: Mr. F. Cass, Aird & Berlis LLP
All Interested Parties EB-2010-0042 (email only)

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 the clearance or disposition of amounts recorded in certain deferral or variance accounts.

ENBRIDGE GAS DISTRIBUTION INC.
ARGUMENT IN CHIEF

STOCK BASED COMPENSATION EXPENSES IN
ENBRIDGE'S 2009 EARNINGS SHARING CALCULATION

At the conclusion of the interrogatory and ADR phases of this proceeding, Enbridge Gas Distribution Inc. (EGD, or the Company) and all other parties to the proceeding filed a settlement proposal in which all but one element of the Company's 2009 earnings sharing calculation were resolved. The unresolved element relates to EGD's 2009 stock based compensation (SBC) costs that are part of its operating and maintenance (O&M) expense used in the determination of Utility earnings for earnings sharing purposes.

In its Decision and Procedural Order No. 2, the Ontario Energy Board (OEB or the Board) determined that it would address the following issue by way of written submissions:

> Is the amount included for stock-based compensation expenses in Enbridge's 2009 Earnings Sharing calculations appropriate? (referred to as the SBC Issue)

The Board directed the Company to file argument in chief on this issue by today's date.

Overview

The Company's 2009 SBC costs for regulatory purposes have been calculated in the same manner for a number of years, including during the base year and subsequent years of the current incentive regulation (IR) term. For 2009, EGD included a SBC expense of $4.3 million in its earnings sharing calculation.

In accordance with past practice, and in alignment with accounting standards, and the principle that expenses should be matched to the services provided/received, EGD's

SBC costs are expensed over the period when the related employee services are received. This means that EGD's 2009 SBC costs relate to SBC grants from 2009, as well as those from previous years, to the extent that they have not vested. If EGD was required to expense the full cost of SBC grants in one year, then (at least in the short term), its SBC costs would increase.

The Board has previously made a specific determination that the Company's SBC costs are legitimate expenses that are appropriately recovered from ratepayers. The Board has approved EGD's SBC costs for each of 2006, 2007 and 2008. In each of those years, the calculation of the cost was performed in the same manner as for 2009. It is appropriate that the Company's SBC expenses for 2009 should also be approved by the Board for earnings sharing purposes.

At present, EGD is not aware of the precise nature of intervenor concerns or objections to its 2009 SBC costs. The Company intends to provide its response to any issues raised by intervenors as part of its Reply submissions, once intervenors have filed their argument.

Background[1]

Within the EB-2006-0034 rate proceeding (2007), EGD filed an independent review of the RCAM, as directed by the OEB in its EB-2005-0001 Decision. As part of phase I of the 2007 proceeding, EGD and stakeholders filed an agreement with the OEB concerning the regulatory cost allocation methodology (RCAM) and the level of costs produced by the methodology to be included within utility O&M. The agreement was approved by the OEB. Two items remained outstanding from that agreement, one of which related to the cost of SBC embedded within the RCAM methodology.

These outstanding items were reviewed and decided upon on by the OEB within a phase II of the EB-2006-0034 proceeding. Within the EB-2006-0034 phase II Decision, the OEB decided that the cost of SBC as included within the RCAM methodology was both required and recoverable within rates.[2] With respect to SBC costs, the Board determined that such costs qualify as a regulatory expense for ratemaking purposes. The Board noted that SBC is an important element of compensation which, if absent, would no doubt be replaced by more expensive compensation alternatives. The Board concluded that it would allow EGD to recover the cost of SBC in rates, stating that "[i]f the Board denied recovery of these costs, they would no doubt be replaced by more

[1] The Company's prefiled evidence, titled "Stock Based Compensation within Utility Financial Results" (Ex. B-6-1) sets out a fuller explanation of the Company's SBC costs that are included as an expense for its 2009 earnings sharing calculation.

[2] The Board's Decision in EB-2006-0034 is attached to Board Staff Interrogatory 10 (Ex. I-1-10).

expensive alternatives which would not benefit the ratepayers or the shareholders."[3]

Since that time, EGD has continued to include SBC costs as part of its O&M expense, whether for the purpose of determining revenue requirement (as in the 2007 base year) or for the purpose of calculating an earnings sharing amount (as was the case for 2008 and 2009). There has been no debate over the amount of EGD's SBC costs in 2007[4] or 2008, and those amounts have been approved by the Board, as part of EGD's overall expenses.

The SBC expenses included in EGD's O&M costs for 2007, 2008 and 2009 include a number of components: (a) incentive stock options (ISOs); (b) performance stock units (PSUs); and (c) restricted stock units (RSUs).[5]

The manner in which SBC costs are expensed for regulatory purposes depends upon the various types of SBC instruments used, and the treatment required by the applicable accounting standards, as briefly described below.[6]

> *Incentive stock options:* ISOs provide the right to purchase common shares of Enbridge Inc. (EI) at a specified price during a specific period of time. The purchase price (or strike price) of EI's options are set at the market price of EI's shares on the date the options are granted. Generally, these options vest in equal annual installments over a four-year period and expire ten years after the grant date. In order to be compliant with accounting requirements, EGD expenses the fair value of ISO grants evenly over each year of the vesting period of four years.
>
> *Restricted stock units*[7]: The RSU plan grants notional units as if one unit was one EI common share. RSU holders receive cash per outstanding unit equal to EI's weighted average share price at the time of maturity, 35 months from the date of the grant. The outstanding units accumulate notional dividends during their validity. RSU grants are expensed over the 35 month duration of their validity.

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[3] See p. 6 of the Board's Decision in EB-2006-0034 (phase II).

[4] The debate in phase II of the 2007 rate case related to recoverability of SBC expenses, not to the quantum of those expenses.

[5] EGD's witnesses explained the nature of each of these elements of its SBC plan as part of their testimony in the EB-2006-0034 (phase II) proceeding – see, for example, Tr. 17 at pp. 52 to 53 and 128 to 130.

[6] More detail can be found in EGD's prefiled evidence (Ex. B-6-1), at paras. 16-18, and in response to SEC Interrogatories 9 to 11 (Ex. I-5-9 to 11).

[7] There is further discussion of RSUs set out in response to VECC Interrogatory 14 (Ex. I-4-14).

> *Performance stock units*: The PSU plan grants notional units as if one unit was one EI common share. PSU holders receive cash awards following a three-year performance cycle. Awards are calculated for each outstanding unit at the end of the performance period using the EI weighted average share price and a performance multiplier. PSU grants are expensed over the three year duration of their validity using a formulaic based approach, which makes reference to the EI stock performance relative to the pre-determined peer group.

Thus, as described above, the recognition of expense of SBC grants in any particular year is recorded on a pro-rated basis to reflect the vesting pattern of the underlying grant. This means that EGD's 2009 SBC costs relate to SBC grants from 2009, as well as from previous years. Hypothetically, if grants were to be expensed immediately at the time of grant there would be a disconnect between the basis of expensing and the associated value derived by the organization. Further, such an approach would be out of alignment with accounting requirements.[8] If EGD was required to expense the full cost of SBC grants in one year, then (at least in the short term), its SBC expenses for regulatory purposes would increase.[9]

The above basis of accounting for SBC costs was used in the calculation of RCAM amounts within the EB-2006-0034 proceeding, in which the OEB set the base rates for EGD's IR term. In that proceeding, a total RCAM amount of $18.1 million, inclusive of $1.7 million of EGD related SBC costs, was approved by the OEB.[10]

The same basis of accounting for EGD's SBC costs (which amounted to $3.1 million) was also used for 2008, and included as part of EGD's Board-approved 2008 Earnings Sharing Mechanism (ESM) Application (EB-2009-0055). As such, the 2008 total SBC grant recognition wasn't expensed entirely in 2008 but rather pro-rated over 2008, 2009, 2010 and 2011.[11]

<u>The Company's 2009 SBC Costs</u>

In order to arrive at a proposed 2009 ESM amount owing to ratepayers of $19.3 million, EGD's EB-2010-0042 ESM application sets out the components of revenues and

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[8] See paragraph 48 of Section 3870 of the Handbook of the Canadian Institute of Chartered Accountants (an excerpt of which is reproduced at page 5 of Ex. B-6-1).

[9] See response to VECC Interrogatory 11: Ex. I-4-11(c).

[10] See EGD's prefiled evidence (Ex. B-6-1), at para. 19. The same basis of accounting was used for the 2006 test year (and the results were approved by the Board – see EB-2005-0001, Decision with Reasons, at pp. 87 and 89) – see VECC Interrogatory 14 (Ex. I-4-14(a)).

[11] See EGD's prefiled evidence (Ex. B-6-1), at para. 20.

expenses used within the determination of Utility earnings. One element of the O&M expenses included within the ESM calculation is SBC costs, in conformity with RCAM. The application of the RCAM methodology resulted in an allocation of $21.2 million of corporate costs to EGD for 2009, which includes an SBC related amount of $4.3 million.[12]

The following table sets out EGD's 2009 RCAM SBC costs, broken out by the type of SBC instrument, and by year of grant.[13]

($ millions)	**Year of Grant**				
	2009	**2008**	**2007**	**2006**	**Total**
ISOs	1.0	0.1	0.3	0.2	1.6
RSUs	0.8	0.6	0.9	-	2.3
PSUs	0.1	0.1	0.2	-	0.4
	1.9	**0.8**	**1.4**	**0.2**	**4.3**

These costs are calculated in the manner described above, consistent with the approach used in past years.[14]

Set out below is a breakdown of EGD's 2008 and 2009 SBC costs, calculated in accordance with RCAM. The 2008 SBC costs were included within EGD's 2008 O&M expenses that were used and approved for ESM purposes.

($ millions)	**2008**	**2009**
ISO	1.1	1.6
RSU	1.3	2.3
PSU	0.7	0.4
RCAM based direct SBC expense	**3.1**	**4.3**

[12] See response to VECC Interrogatory 5 (Ex. I-4-5).

[13] Ex. I-4-13, p. 5.

[14] As explained in EGD's prefiled evidence, these costs are different from EGD's corporate SBC costs set out in its Consolidated Financial Statements: see prefiled evidence (ex. B-6-1) at paras. 7 to 11. SBC amounts on the financial statements do not lend themselves to comparison with the RCAM amounts for reasons noted in Board Staff Interrogatory 12 (Ex. 1-1-12).

The main reason for the increase in SBC costs from 2008 to 2009 relates to the RSU expenses. RSUs were introduced to compensation packages on a limited basis in late 2006, and were not included within RCAM expenses until 2008 (because RSUs were not included within the budget that formed the basis for the 2007 RCAM expenses). Given that RSUs are expensed over a three year period (as described above), it is only in 2009 that the full impact of these expenses is reflected in the SBC costs because 2009 is the first time that three year's worth of grants are being expensed (for 2007, 2008 and 2009). The aggregate cost of ISO and PSU expenses has remained relatively constant, although the allocation between the two components has changed.[15]

All of which is respectfully submitted this 20th day of August 2010

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

[15] See prefiled evidence (Ex. B-6-1), at paras. 20 and 21.