EB-2006-0606
EB-2007-0615

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

AND IN THE MATTER OF an Application by Union Gas Limited for an Order or Orders approving a multi-year incentive rate mechanism to determine rates for the regulated distribution, transmission and storage of natural gas, effective January 1, 2008;

AND IN THE MATTER OF an Application by Enbridge Gas Distribution Inc. for an Order or Orders approving or fixing rates for the distribution, transmission and storage of natural gas, effective January 1, 2008;

AND IN THE MATTER OF a combined proceeding before the Board pursuant to section 21(1) of the *Ontario Energy Board Act, 1998*.

REPLY ARGUMENT

OF

ENBRIDGE GAS DISTRIBUTION INC.

I Introduction

1. This is the reply of Enbridge Gas Distribution Inc. ("Enbridge" or the "Company") to the arguments of Green Energy Coalition ("GEC") and Pollution Probe regarding the issue of customer additions.

2. GEC proposes that Enbridge be rewarded or penalized if its customer attachments in any year of the term of its incentive regulation plan ("IR Plan") exceeds or falls below a

specified level or "pivot point." Pollution Probe proposes that the capital costs associated with customer attachments be afforded "Y factor" treatment.

3. Enbridge submits that neither GEC nor Pollution Probe have demonstrated that there is any need for special incentives or Y factor treatment.

II Overview

4. A common concern underlies the proposals of the GEC and Pollution Probe as they pertain to Enbridge: that incentive regulation ("IR") will reduce the Company's incentive to invest capital and that, in the result, system expansion and/or customer attachments will be sacrificed at the altar of short-term profit and return objectives.

5. In Enbridge's view this concern is without merit. There are two reasons why. The first has to do with Enbridge's choice of an IR Plan. The second has to do with the nature of Enbridge's core business.

(a) Enbridge's IR Plan

6. Enbridge's IR formula explicitly recognizes increases in the number of customers as the measure of system growth, by increasing revenue requirement on a per customer basis. The revenue for the rate year is *equal* to the revenue of the previous year *divided* by the average number of customers in the previous year, multiplied by an inflation adjustment factor *multiplied* by the forecast average number of customers for the rate year *plus* adjustments for the cost of defined items on a cost of service basis (Y and Z factors).

7. It is precisely because of the growth pressures that Enbridge faces in its franchise area that it applied for a per customer revenue cap as opposed to the price cap mechanism. It is precisely because of its desire to be able to meet in-franchise market demand that, throughout the course of this proceeding, Enbridge continued to advocate in favour of a per customer revenue cap mechanism.

8. A number of new gas-fired power plants are expected to be constructed in Enbridge's franchise area during the term of the IR Plan. The costs associated with attaching such plants may be considerable. The Agreeing Parties (as that term is defined in the

Settlement Agreement) recognized that this could place an undue constraint on the Company's capital spending. In the result, the parties agreed to the inclusion of a "Power Plan Y Factor" in the IR Plan. In each year of the IR Plan, the incremental revenue requirement impacts associated with capital expenditures related to new, Board-approved natural gas-fired power generation projects, will be added to the revenue requirement as determined by the IR formula.

9. The combination of the revenue per customer cap formula and the Power Plant Y Factor is the basis of Enbridge confidence that its year-over-year revenue growth will be sufficient to compensate it for the costs of serving existing customers and adding new ones.

III Enbridge's core business

10. The distribution of natural gas is at the very core of the Company's business. One of the most effective ways to grow this business is to add new customers. The pursuit of short-term financial objectives at the expense of longer term financial returns would erode the Company's core business and, ultimately, impair its financial viability.

11. Enbridge's witnesses testified that customer attachment capital is the Company's second capital spending priority, ranking just below the maintenance of safety and integrity:

> [W]e understand that the opportunity to attach a customer to a certain extent comes along once a decade, so if they choose an alternate fuel, its very, very hard to get them back on the natural gas, and we've lost an opportunity that we don't want to lose. [2Tr.69]

12. In the shorter term, cutting revenue-producing capital investment would be just as unwise. As Enbridge's witnesses testified:

> MR. LADANYI: … under incentive regulation, if a utility is short of revenues, it would be the very last thing you would want to do is cut revenue-producing capital investment. You certainly would

> want to cut operating, maintenance costs first, and then non-revenue-producing capital. Really, the very last thing you would want to do is cut something that brings in dollars. [2Tr.84]
>
> …
>
> MR. HOEY: And even more importantly, with the revenue cap per customer, cutting any customer additions would also reduce us by an average $400 every year too, so we really don't have any incentive to do that. [2Tr.84]

13. In light of the above testimony, it is clear that the reaction of the Company's management to an economic downturn or to a warmer than normal winter would be, first, to constrain discretionary, non-capital spending and, next, to constrain non-revenue producing capital (to the extent possible without jeopardizing safety and integrity). Cutting revenue-producing capital would simply be counter-productive.

14. Attached as Appendix C to the Settlement Agreement are schedules that set out the estimated distribution revenue impacts for the years 2008-2012. These estimates are derived from specific assumptions that Enbridge has made with respect to certain key variables such as volumes, customers and average use. In the Settlement Agreement (p. 5), Enbridge represents that these underpinning assumptions, including assumptions regarding customer additions, are not expected to materially change from the values used to derive the estimates.

IV Pollution Probe

15. While Pollution Probe acknowledges that new customer additions are in the long-run self interest of Enbridge it submits, nevertheless, that without a customer attachment Y factor, the number of attachments under IR will be less relative to the number under cost-of-service. Pollution Probe relies on a 5-year revenue analysis to make its case in this regard. It notes that *on a stand-alone basis,* the cumulative five year *revenue deficiency* of Enbridge's new customer additions, in 2006, was $4.458 million (Pollution Probe Argument, p. 5).

16. While Pollution Probe's mathematics are correct, its analysis is incomplete. It ignores the fact that in any five-year period, customer additions made in prior years (10, 20, or more years earlier) may result in a *revenue sufficiency*. This revenue sufficiency will reduce and, potentially, even offset the cumulative revenue deficiency associated with new customer additions.

17. Pollution Probe also argues that IGUA's arguments on the issue of customer attachments assumes that Enbridge "will undertake a certain minimum number of new customer additions during each of the next 5 years." [Pollution Probe Argument, p. 8] This is not the Company's perspective and it believes that IGUA understands the issue. The Company believes that the revenue per customer cap model provides incentive to add customers and that it expects to add customers in a manner similar to that under cost of service regulation. Further, as Mr. Hoey stated, Y factor incentives, in addition to the incentive offered by the revenue cap per customer formula, would result in an unnecessary windfall to the Company.

V GEC

18. GEC proposes a targeted symmetrical incentive for total customer additions of $141 per addition, above or below 66.2% of Ontario housing starts or, alternatively, 102.6% of housing starts in Enbridge's franchise area. These thresholds are based on the actual five-year averages for the period 2002-2006. GEC maintains that its proposal is "revenue neutral".

19. The GEC proposal will be revenue neutral if, and only if, the "average housing starts" to "new customer attachment" ratio in the period 2008-2012 turns out to be exactly the same as that ratio in the period 2002-2006. If it does not, Enbridge will be rewarded or penalized, as the case may be, for factors beyond its control. There are many such factors: the economic climate, planning restrictions that push housing developments further and further away from the existing distribution system [2Tr.103] and a decreasing pool of potential "electricity to gas" conversions [2Tr.103-104], to name a few.

20. GEC's proposal (as well as Pollution Probe's, for that matter) will require the Company to develop additional administrative and regulatory processes which will, no doubt, be time-consuming and not without controversy. As Mr. Hoey testified: "[W]e will have to create some kind of tracking mechanism to prove either we're on the line, above the line or below the line, and then we'll have to have some process for that to be cleared in this regulatory forum…if either we are being penalized or whether we are asking for an additional collection from customers, I guarantee you that will be controversial from one side or the other [2Tr.94-95]." Moreover, the dollar amount of GEC's proposed incentive is inconsequential. For example, if customer attachments varied by as much as 10,000 customers (about 25% of the forecast for 2008), the incentive would be $1.41 million, an amount that is less than the dollar threshold for Z factors.

VI Conclusions

21. For all of the above-noted reasons, Enbridge urges the Board to reject the proposals of GEC and Pollution Probe and approve the Settlement Agreement as filed.

ALL OF WHICH IS RESPECTFULLY SUBMITTED on behalf of Enbridge Gas Distribution Inc., by its counsel, this 8th day of February, 2008.

(signed) H.T. Newland
H.T. Newland