500 Consumers Road
North York ,ON M2J 1P8
P.O. Box 650
Scarborough, ON
M1K 5E3

Lesley Austin
Regulatory Coordinator, Regualtory Affairs
Tel 416-495-6505
Fax 416-495-6072
Email: Lesley.Austin@enbridge.com

February 3, 2012

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") – Argument in Chief
2012 Rate Adjustment Application ("Application")
Ontario Energy Board ("Board") File Number EB-2011-0277

Pursuant to the dates set out during the Oral Hearing for this proceeding, enclosed please find Enbridge's Argument in Chief.

This submission has been filed through the Board's Regulatory Electronic Submission System ("RESS"), and two hard copies are being sent to the Board as directed. Enbridge's filing for this proceeding can be found on the Enbridge website at: www.enbridgegas.com/ratecase.

If you have any questions, please contact the undersigned.

Sincerely,

[Original Signed By]

Lesley Austin
Regulatory Coordinator, Regulatory Affairs

cc: Mr. F. Cass, Aird & Berlis LLP (via email and courier)
All Interested Parties EB-2011-0277 (via email)

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

AND IN THE MATTER OF an application by Enbridge Gas Distribution Inc. for an Order or Orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas commencing January 1, 2012.

ENBRIDGE GAS DISTRIBUTION INC.
ARGUMENT IN CHIEF

A. Introduction

1. In its Partial Decision and Order issued on December 1, 2011, the Board accepted the Settlement Agreement in this proceeding that was attached as Appendix "A" to the Board's Order. The Board also identified the seven issues that were not settled (with reference to the Board-approved Issues List), as follows:

   (i) Y factor – Gas Cost & Carrying Cost (Issue 9);
   (ii) Z factor – 2012 Pension Funding (Issue 10);
   (iii) Z factor – 2012 Cross Bores/Sewer Laterals (Issue 11);
   (iv) Variance account for Z factor – 2012 Pension Funding (Issue 13);
   (v) Variance account for Z factor – 2012 Cross Bores/Sewer Laterals (Issue 14);
   (vi) Transition Impact of Accounting Changes Deferral Account (Issue 15); and
   (vii) Cost allocation of Z factors (Issue 17).

2. During the oral hearing Enbridge Gas Distribution Inc. (Enbridge, or the Company) called four witness panels to address these seven issues. The first witness panel responded to questions about Gas Cost & Carrying Cost. The second witness panel addressed the 2012 Pension Funding Z factor, the proposed variance account for the Pension Funding Z factor and any cost allocation issues relating to this Z factor. The third witness panel addressed the Transition Impact of Accounting Changes Deferral Account (TIACDA). The fourth witness panel answered questions about the Cross Bores/Sewer Laterals Z factor, the

proposed variance account for the Cross Bores/Sewer Laterals Z factor and any cost allocation issues relating to this Z factor.

3. Under the headings that follow, Enbridge will group its arguments with regard to the seven unsettled issues in the same manner as those issues were grouped for the purposes of the witnesses panels called at the oral hearing.

B. Gas Cost & Carrying Cost

4. As it does every year, Enbridge developed a gas supply portfolio in order to ensure that it will be able to meet the needs of its customers during 2012. In developing this portfolio, Enbridge must put in place arrangements for the supply and transportation of gas to meet annual, seasonal and peaking needs.[1] The numerous elements of the gas supply portfolio include Western supplies, peaking contracts, Chicago supply, delivered supply, gas in storage, long haul transportation on the systems of TransCanada Pipelines (TCPL), Alliance and Vector, short haul contracts on the TCPL system, such as Storage Transportation Service (STS), and transportation on the Union Gas system to move gas from Dawn to Parkway.[2]

5. Enbridge continues to add a considerable number of customers each year and, consistent with the nature of Enbridge's customer base, these tend to be customers that place additional demands on Enbridge's ability to meet peak day demands. For the winter of 2011-2012, Enbridge expected that it would need to meet an incremental peak day demand of 50,000 Gj/day.[3] As well, it was necessary for Enbridge to plan for other factors that would impact the gas supply portfolio, such as customers migrating back to system supply and changes in degree days.

6. While Enbridge draws on a number of supply and transportation resources to meet the demands of its customers, the resources available to meet incremental peak day demands

[1] 1 Tr. 4

[2] Ex. B-4-1, pp. 1-6 and 1 Tr. 4-5.

[3] 1 Tr. 24.

are limited. For planning purposes, Enbridge assumes that, on peak day, all of its long haul and short haul contracts, as well as curtailment, are fully utilized. This leaves incremental long haul capacity, specifically Short Term Firm Transportation (STFT), and peaking services as the only incremental supply options for peak day.[4]

7. Enbridge has been concerned because largely the same gas suppliers have been providing Peaking Services, Direct Purchase supply and Curtailment Delivered Supply (CDS). These concerns became reality in January and February of 2011 when certain direct purchasers customers had their deliveries (Mean Daily Volume) cut by their suppliers, there were cuts of CDS and one of Enbridge's peaking suppliers failed to deliver gas when called upon to do so, as a result of that supplier having its supplies cut.[5] Based on these events during the winter of 2010-2011 and the expected demands on the system in 2012, Enbridge took the following steps when developing its 2012 gas supply portfolio:

   (i) the amount of peaking services was reduced from the level contracted for in respect of the 2010-2011 winter;

   (ii) an additional 75,000 Gj/day of STFT was acquired for three winter months; and

   (iii) an assignment was taken for 26,956 Gj/day of TCPL-FT Empress to Iroquois capacity.[6]

8. Out of all of the elements of Enbridge's 2012 gas supply portfolio, certain intervenors have made an issue of one of the three actions referred to in paragraph 7, namely, the acquisition of additional STFT for three winter months in 2012. These intervenors apparently have focused on the acquisition of STFT because the elements of the "Long Term Resolution" agreed to in the Board-approved Settlement Agreement in EB-2010-0231 (the "system reliability" proceeding) also include STFT. Intervenors suggest that, before developing its 2012 gas supply portfolio, Enbridge should have consulted with the parties to the system reliability proceeding.

---

[4] 1 Tr. 5

[5] Ex. B-4-1, p. 5, para. 11.

[6] Ex. B-2-5, p. 5, para. 11.

9. As stated, Enbridge develops each year's gas supply portfolio in order to ensure that it will be able to meet the annual, seasonal and peaking needs of its customers. The successful management of the gas supply portfolio involves use of the SENDOUT model, as well as application of the judgment, experience and expertise of Enbridge's management, but it does not involve weighing or assessing the views of a diverse range of stakeholders on the many elements of the gas supply portfolio. Simply put, it is not reasonable, practical or appropriate for Enbridge to attempt to consult with a group of stakeholders and/or intervenors when it puts together each year's gas supply portfolio.

10. The EB-2010-0231 Settlement Agreement sets out the Long Term Resolution of the "system reliability issue".[7] The "system reliability issue" referred to in the Settlement Agreement is the issue that was addressed in the Board's EB-2008-0219 Phase 2 Decision and Order (the Phase 2 Decision).[8] The issue addressed in the Phase 2 Decision was whether direct purchase bundled service customers should be required to contract for firm upstream transportation.[9]

11. In the Phase 2 Decision, the Board ordered an "interim resolution of the system reliability issue", which involved an amendment of the rate handbook to require direct shippers to underpin a certain percentage of their gas deliveries with firm transport.[10] The Board also gave directions regarding a "long term resolution" of the "system reliability issue";[11] this ultimately became the Long Term Resolution set out in the EB-2010-0231 Settlement Agreement.

12. Enbridge submits that the Long Term Resolution of the particular "system reliability issue" dealt with in the EB-2010-0231 Settlement Agreement does not require or contemplate that

---

[7] Ex. I-6-11, p. 8 (EB-2010-0231, Ex. C-1-1, p. 4).

[8] Ex. I-6-11, p. 7, footnote 1 (EB-2010-0231, Ex. C-1-1, p. 3).

[9] EB-2008-0219 Phase 2 Decision and Order, at p. 3 (setting out Issue 7 from the EB-2010-0219 Board-approved Issues List) and following, to p. 16.

[10] EB-2008-0219 Phase 2 Decision and Order, p. 9.

[11] EB-2008-0219 Phase 2 Decision and Order, p. 11.

Enbridge will consult with parties to the Agreement in respect of every gas supply decision that can be seen to involve reliability of gas supply. Much less does the Settlement Agreement require or contemplate that Enbridge will consult with parties to the Agreement before it puts together a gas supply portfolio to meet annual, seasonal and peaking needs of customers.

13. In this regard, the evidence of the Enbridge witnesses was as follows:

> ...we feel that we have implemented the system reliability decision. So all aspects of it, we have implemented it. We implement in 2011 and we will continue to do so in the spirit of this agreement.
>
> What we are talking about now, though, is what our 2012 portfolio is supposed to be; we are not talking about system reliability as defined in this proceeding.
>
> As Mr. Small said earlier, that was really to negate against the effects of direct shippers' gas coming in that wasn't firm. We have the same tools available to us in that decision – i.e. the use of STFT or peaking service – that we do to manage our 2012 portfolio.[12]

In other words, the fact that the elements of the Long Term Resolution include the acquisition of STFT does not mean that any subsequent decision to acquire STFT as part of a particular year's gas supply portfolio must be the subject of consultation with the parties to the system reliability proceeding. For the reasons stated above, long haul capacity, specifically STFT, and peaking services happen to be the only supply options available to Enbridge at this time to meet incremental peak day requirements.[13]

14. Quite apart from the distraction caused by the suggestion that the system reliability proceeding should be re-opened, the evidence is clear that the 75,000 Gj/day of STFT contracted for by Enbridge is needed as part of the 2012 gas supply portfolio. As stated by Mr. Small:

> But if we are saying, okay, we are going to walk away from that contract, we are still left with the obligation to ensure that we are going to meet what the demands of our customers are.

[12] 1 Tr. 65-66.

[13] 1 Tr. 33

> So we would need to find some alternative, and I come back to the argument that I don't believe that there is another alternative at this point in time.[14]

15. Unlike peaking services, STFT can be utilized both to meet peaking needs and seasonal needs. Mr. Small's evidence was that:

> ...in looking at what our peak day requirement was, we recognized what we needed for additional supplies to meet our peaking requirement, so we went with the STFT. Now, it does satisfy our peak day requirements, but then you can also use that supply to satisfy your winter demands, as well.[15]

16. Not only is the STFT contracted for by Enbridge available to meet seasonal needs, it is being used for that very purpose, as explained by Ms Sarnovsky in the following testimony:

> As the portfolio sits right now, though, that incremental STFT that you are talking about is fully utilized for franchise requirements. So we are using it each and every one of those 90 days.
>
> So it's being utilized for franchise needs. It's not available for TS.[16]

17. Enbridge therefore respectfully requests that the Board approve the proposed 2012 Gas Cost and Carrying Cost, including the costs of the 75,000 Gj/day of STFT that form part of the 2012 gas supply portfolio.

C. Pension Funding Z Factor

18. In 2012, Enbridge will be required to contribute the current year's service cost to the pension plans for its employees. The amount of this cost is estimated to be $16.6 million[17] and Enbridge submits that this cost meets all of the criteria for Z factor treatment under the provisions of Enbridge's Incentive Regulation plan. Enbridge proposes that a variance account be established to record any difference between the estimated amount of $16.6 million and the actual amount that must be contributed to the plans in 2012.

---

[14] 1 Tr. 27.

[15] 1 Tr. 57-58.

[16] 1 Tr. 71.

[17] Ex. B-2-5, p. 4, para. 12 and 1 Tr. 95.

19. At the time of the commencement of Enbridge's Incentive Regulation plan, the Financial Services Commission of Ontario (FSCO) required a valuation for all registered pension plans to be filed every three years. A valuation for Enbridge's pension plan was required on December 31, 2009 and that valuation showed the pension plan to be in a significant surplus position, meaning that no requirement for further contributions was triggered. The next valuation was not due until the end of the Incentive Regulation plan, December 31, 2012.[18]

20. However, on June 23, 2009, a new requirement was introduced in Ontario that requires the sponsors of plans on a "contribution holiday" to file an annual actuarial cost certificate with FSCO to justify continuation of the holiday.[19] If a plan sponsor is unable to file the actuarial cost certificate showing that its plan is in a surplus position on both the "solvency" and the "going concern" basis, the requirement to contribute the annual service costs is triggered. But for this change that occurred in 2009, Enbridge could have remained in a contribution holiday until the end of 2012 even with interim deficit positions.[20]

21. Pursuant to the requirement introduced in June of 2009, Enbridge must file an actuarial cost certificate showing that its pension plan is in a surplus position as of December 31, 2011 in order to continue the contribution holiday. At the request of Enbridge, Mercer estimated the projected December 31, 2011 financial position of the plan based on economic conditions as at August 31, 2011.[21] Mercer concluded that the plan would be in a deficit position on the solvency basis as of December 31, 2011 given economic conditions at August 31, 2011.

22. There is no realistic possibility that the deficiency will be entirely eliminated as of December 31, 2011, as was explained in the following testimony by Mr. Monteiro:

> So this report contains a point estimate ... we talk about the kinds of things that would need to have improved from August 31st until December 31st in order for the plan to be in a surplus position.

---

[18] Ex. B-2-5, p. 2, para. 5.

[19] Ex. B-2-5, p. 2, para. 5.

[20] 1 Tr. 94

[21] Ex. B-2-5, App. B, p. 1

> So we said the pension fund return would have had to have been 16 percent for those four months, with no interest rate changes, or interest rates would have to have increased by one percent with fund returns being as expected.
>
> Neither of those two things have happened.[22]

Accordingly, there is every reason to expect that Enbridge will be unable to file an actuarial cost certificate showing a surplus in the plan on December 31, 2011 and the requirement to contribute the 2012 service costs will be triggered.

23. Enbridge submits that the requirement to fund the current year's service cost of the pension plan in 2012 is, in essence, an archetypal Z factor. The payment of pension costs for employees is very much a legitimate and prudent cost to support the provision of service to Enbridge's customers and, as already stated, the requirement triggered in 2012 meets all of the Z factor criteria.

24. The parameters of Enbridge's Incentive Regulation plan, including the Z factor criteria, are set out in the Board-approved Revised Settlement Agreement in EB-2007-0615. Pursuant to the EB-2007-0615 Revised Settlement Agreement, Z factors "generally have to meet the following criteria":

    (i) the event must be causally related to an increase/decrease in cost;

    (ii) the cost must be beyond the control of Enbridge's management and is not a risk in respect of which a prudent utility would take risk mitigation steps;

    (iii) the cost increase/decrease must not otherwise be reflected in the per customer revenue cap;

    (iv) any cost increase must be prudently incurred; and

    (v) the cost increase/decrease must meet the materiality threshold of $1.5 million annually per Z factor event.[23]

---

[22] 1 Tr. 112.

[23] EB-2007-0615 Decision of the Board, Sched. A, p. 21 (EB-2007-0615, Ex. N1-1-1, p. 21).

25. The cost that Enbridge will incur to fund the 2012 service costs of the pension plan is not reflected in the per customer revenue cap under the Incentive Regulation plan (indeed, Enbridge was on a contribution holiday at the beginning of the Incentive Regulation plan) and it clearly exceeds the materiality threshold of $1.5 million annually.

26. The requirement to fund the pension service costs in 2012 is driven by events that are causally related to the increase in cost and that were beyond the control of Enbridge's management. But for the introduction of the annual certificate requirement in June of 2009, the performance of financial markets and changes in interest rates after 2009 would not have mattered and Enbridge would have been able to continue on a contribution holiday at least until December 31, 2012. The advent of the new requirement in 2009 was beyond the control of Enbridge's management and was not an event in respect of which Enbridge could have taken risk mitigation steps.

27. Moreover, the circumstances that have given rise to the deficit in Enbridge's pension plan were beyond the control of management and were not events in respect of which Enbridge could have taken risk mitigation steps. The financial position of most pension plans in Canada has declined significantly due to weak equity markets and declining interest rates. In fact, Enbridge's plan has been able to "weather this storm" better than most, because it was in a significant surplus position prior to the last few years, while many other plans were in a deficit position before the 2008 financial crisis.[24] The change in the position of Enbridge's plan from a surplus to a deficit has occurred largely because of three reasons: (i) contributions to the plan have not been required for a long time, even though annual service costs have been incurred; (ii) the performance of pension assets has not been able to keep up with the growth of pension liabilities; and (iii) pension liabilities increased significantly in the last year essentially because the discount rates for the liabilities valuation, which are based on long-term Canadian bond yields, have been very low.[25]

---

[24] 1 Tr. 93.

[25] 1 Tr. 93.

28. Canadian Manufacturers & Exporters (CME) apparently takes the position that changes in costs caused by reductions in interest rates are "Z factor ineligible".[26] Nowhere in the evidence in this case, or in the EB-2007-0615 Revised Settlement Agreement, is it stated or even implied that changes in costs caused by reductions in interest rates are "Z factor ineligible". CME seeks to add a new Z factor criterion that has never been part of Enbridge's Incentive Regulation framework.

29. CME says, alternatively, that if changes in costs caused by reductions in interest rates qualify as a Z factor, ratepayers are entitled to the benefit of reduced debt costs caused by lower interest rates. This again is a position devised by CME that bears no relationship to Enbridge's Incentive Regulation framework. This was explained by Mr. Culbert in the following evidence given in response to questions from counsel for CME:

> Well, the company's understanding of the manner in which rates are set during its IR term, and as specified in the agreement as approved by the Board, for rate-setting purposes there was to be no change in costs of capital for rate-setting purposes.
>
> So the company's view is, by association, there is also – as that agreement is based on that, there is no requirement for a Z factor for those elements of cost of capital either, cost of capital including return on equity, and these costs were part of the structure of the rate-setting model, and the Z factor would follow suit.
>
> ... Well, as I said, in terms of rate-setting we are not changing any cost of capital when we set rates during the term. So to the extent that there's a benefit that flows through to the bottom line, that is taken care of in the earnings-sharing mechanism that is part of the overall package.[27]

30. Enbridge therefore submits that the 2012 pension costs meet all of the Z factor criteria and it requests that the Board approve both the Z factor and the proposed variance account that would capture any difference between the estimated costs of $16.6 million and the actual 2012 costs.

---

[26] Email dated January 27, 2012 from CME counsel to the other parties to this proceeding and Board staff.

[27] 1 Tr. 168.

D. 2012 Transition Impact of Accounting Changes Deferral Account

31. Enbridge seeks to establish the 2012 Transition Impact of Accounting Changes Deferral Account (2012 TIACDA) in order to recognize and record the financial impacts that will occur in relation to Enbridge's required transition away from Canadian Generally Accepted Accounting Principles (CGAAP). The evidence is clear that the purpose of establishing a 2012 account is to reflect impacts that will occur in 2012.[28]

32. Enbridge was required to move away from CGAAP beginning January 1, 2012[29] and it has identified a significant impact of this mandatory change which relates to Other Post Employment Benefits (OPEBs).[30] OPEBs are post-employment benefits, other than pension plans, such as dental plans, medical plans and life insurance coverage.[31] Unlike pensions, there is no standalone trust or plan in order to hold the funds for future payment of OPEBs; rather, Enbridge currently has a balance sheet liability with respect to payments to be made to retired employees or future retired employees.[32]

33. Until the end of 2008, Enbridge accounted for OPEBs on a cash basis but, as of 2009, CGAAP required that Enbridge convert from the cash basis to the accrual method. At that time, Enbridge recorded a regulatory offset to match the OPEB liability on its balance sheet.[33] As stated by Mr. Yuzwa:

> In 2008, the Accounting Standards Board said that it would be discontinuing Canadian generally accepted accounting principles, and transitioning to IFRS.
>
> However, there was uncertainty around what the international financial reporting standards would be and their application in Canada. So at the same time, we lost the exemption for the ability to maintain the cash method, so at that point in time we knew we had to go to the accrual method of accounting.

---

[28] Ex. C-1-5, p. 1, para. 1.

[29] Ex. C-1-5, p. 1, para. 2.

[30] 2 Tr. 5

[31] 2 Tr. 6.

[32] 2 Tr. 5-6.

[33] 2 Tr. 8

> And considering the uncertainty around IFRS and where we would go, we looked at maintaining consistency in terms of our reporting, and under Canadian Accepted Accounting Principles at that point in time, we were allowed the establishment of a regulatory deferral account to essentially make our financial statements the equivalent to the cash method, which is what we were filing under for regulatory purposes.
>
> So we would have the same sort of income tax statement and transparency in that expense in our financial statements as we did in our regulatory statements, until such time as there was some certainty or some guidance around the application of IFRS.[34]

34. As a result of the requirement to move away from CGAAP, Enbridge can no longer retain the regulatory offset. This is the case regardless of whether Enbridge moves to United States Generally Accepted Accounting Principles (USGAAP) or Modified International Financial Reporting Standards (MIFRS).[35] Mr. Yuzwa's testimony in this regard was as follows:

> And so whether we were on USGAAP or IFRS or any other method, those service costs are a liability from past employees' work, and, as a result, we would have to be – we would be looking for a deferral and the collection of that over a future period.[36]

35. Given that Enbridge moved to USGAAP beginning on January 1, 2012 for corporate reporting purposes, it proposes to record in the 2012 TIACDA the cumulative accounting differences between CGAAP and USGAAP.[37] This includes the regulatory offset of approximately $84 million (determined under USGAAP as at the end of 2010) and the difference between the cash and accrual methods of accounting for OPEBs for 2011 and 2012 amounting to approximately $3 million for each year.[38]

36. Enbridge notes that, in EB-2011-0268, the Board approved a transition to USGAAP effective January 1, 2012 by Hydro One Networks Inc. The Board also approved an "Impact for

---

[34] 2 Tr. 19-20.

[35] 2 Tr. 40-41.

[36] 2 Tr. 23.

[37] 2 Tr. 9.

[38] 2 Tr. 3-4 and 9-10.

USGAAP Account" which, the Board said, "will be a symmetrical variance account to record the 2012 impact of differences between CGAAP and USGAAP".[39]

37. Enbridge is not seeking a decision in this case regarding the recovery of any amounts recorded in the 2012 TIACDA; it proposes the establishment of the account in this 2012 rate adjustment proceeding, with disposition of the account to be considered in its 2013 rate case.[40] Enbridge submits that, because it is required to transition away from CGAAP as of January 1, 2012, the impact of that transition on OPEBs accounting is a 2012 impact that should be recorded in a 2012 account. Indeed, if Enbridge had waited until its 2013 rate filing to bring forward 2012 impacts of the transition away from CGAAP, it expects that, in all likelihood, it would have faced arguments that 2012 impacts should have been addressed in the 2012 case.

38. Mr. Yuzwa gave evidence about the reasons for Enbridge's proposal to establish a deferral account in its 2012 case. He said that:

> So on a timeliness basis and a consistent time frame with our transition away from Canadian generally accepted accounting principles, we wanted to bring this issue forward and have it established in the period which our transition went through.
>
> And so it's, A, a bit of a matching, and B, as Mr. Culbert has said, then we don't have any volatility or changes as we transition. There'll just be the one-year change, and that would make it more transparent, more comparable, rather than having a separate regulatory set of books and a separate accounting set of books.[41]

39. Enbridge therefore seeks approval to establish the 2012 TIACDA to record the financial impacts of its transition away from CGAAP, with disposition of the account to be dealt with in Enbridge's 2013 rate case (or such other case as may be determined by the Board).

---

[39] EB-2011-0268 Decision with Reasons, November 23, 2011, at p. 12.

[40] 2 Tr. 5.

[41] 2 Tr. 42.

E. Cross Bore Z Factor

40. The final outstanding issues relate to Enbridge's request for a Z factor for the costs of its cross bore safety program for 2012. This question is addressed in the Board's Issues List at Issues #11, 14 and 17.

41. The fundamental question underlying these issues is whether Enbridge's cross bore safety program satisfies the criteria for a Z factor as set out in the IR Settlement Agreement. The prefiled evidence and the testimony of the witnesses demonstrate that it is appropriate to establish the Z factor for the Sewer Safety Program (to address cross bore risk) costs.

42. There appears to be no dispute that Enbridge's Sewer Safety Program is an appropriate and prudent response to identified risks related to cross bores.[42] There is also no dispute that Enbridge will only recover the costs of the program in rates if the actual 2012 revenue requirement exceeds the $1.5M Z factor threshold. That will be assured because if a Z factor is allowed, the actual 2012 revenue requirement related to the Sewer Safety Program will be determined at the end of 2012 and recorded in a variance account. To the extent that the actual revenue requirement is different from the forecast revenue requirement recovered through the Z factor, then the difference will be trued up along with the clearance of Enbridge's other 2012 deferral and variance accounts.

43. Based upon the questions asked by intervenors through interrogatories and cross-examination, it seems that the issue between the parties is whether the costs of this prudent program fit within the scope of a Z factor. In Enbridge's submission, that issue is appropriately examined by evaluating the circumstances of this request against the five listed criteria for Z factors set out in the IR Settlement Agreement.

44. To address this issue, one must first look at the background and supporting evidence detailing the cross bore risk, and Enbridge's response to that risk.

45. First, what is a cross bore, and what is the associated danger?

---

[42] See, for example, comments from FRPO at 2 Tr. 111-112.

46. As explained in the prefiled evidence and the testimony in chief of Enbridge's witnesses, in the gas utility context a cross bore is where a gas line passes through another utility line, generally a sewer line. In many cases, cross bores have been created through the installation of gas lines using trenchless installation techniques. While this construction technique has been less costly than alternatives for the Company and ratepayers, it has led to unintended consequences (cross bores). That is because the installer using a trenchless technique cannot see the actual path of the gas line, and may be unaware of the exact location of a sewer line along the installation path.[43]

47. The danger associated with a cross bore arises because the presence of the gas line within the sewer line is unknown. As a result, if there is work within the sewer line, commonly to try to clear a blockage, this may result in disturbing and damaging a gas line. If that happens, the gas will enter the sewer, and will have to escape somewhere. If it escapes into the house, rather than venting into the atmosphere, then there is a real risk of explosion because of sources of ignition (such as pilot lights) within houses.[44]

48. A key question that is addressed in Enbridge's evidence, and was pursued in examination of the witnesses, is that of when and how Enbridge came to be aware of the cross bore issue.

49. The evidence is clear that Enbridge's awareness of the cross bore issue has been an evolutionary process, but that the Company had no knowledge that cross bores were a real risk in its franchise areas at the time that base rates for the IR term were set in early 2007.

50. While Enbridge's affiliate, St Lawrence Gas, experienced a tragic cross bore incident in 2004, the Company did not believe at that time that it faced similar risks in its franchise area.[45] As Ms Lawler explained, Enbridge believed that sewer systems in its franchise area were installed deeper than gas lines, meaning that there was minimal risk of intersection or conflict.[46]

---

[43] Ex. B-2-6, at pages 2 to 3; and 2 Tr. 87-88.

[44] Ex. B-2-6, at page 4; and 2 Tr. 88-89.

[45] Ex. B-2-6, at pages 4 to 5.

[46] 2 Tr. 89-90.

51. Thus, while it may be the case that American jurisdictions were recognizing and addressing cross bore risks around that time, Enbridge did not believe it faced the same risks. Indeed, as seen by the subsequent research and review work conducted through the Canadian Gas Association[47], no Canadian gas utilities had considered cross bores to be a real risk until recently.

52. In her testimony, Ms Lawler explained that Enbridge experienced a "near miss" associated with a cross bore in mid 2007, and this led the Company to more closely evaluate the potential risks within its service areas.[48] Over the next year or so, further investigations led Enbridge to conclude that there was a real risk associated with cross bores in its service areas, and that it needed to take steps to address and mitigate those risks.[49]

53. At that time, around 2008 (well after base rates for the current IR term had been set), Enbridge put together a plan to address the newly-identified risks associated with cross bores in its franchise areas. As explained in the prefiled evidence in this case, and in the prefiled evidence in Enbridge's 2010 rate adjustment proceeding, Enbridge's response to having identified the cross bore risk was to create what it called its Sewer Lateral Initiative.[50]

54. That program was intended to be implemented through 2009 and 2010 (though certain included activities actually began in 2008). This Sewer Lateral Initiative included a variety of <u>new</u> activities to address the cross bore issue in several ways. The goals of the activities were to reduce the risk of creating new cross bores, find existing cross bores and educate the public (especially plumbers and municipalities) about the risks of trying to clear blocked sewer lines without first identifying the location of gas lines.[51]

55. As discussed in testimony, Enbridge included a request for a Z factor for the Sewer Lateral Initiative in the 2010 rate adjustment case, but ultimately agreed as part of a Settlement

---

[47] Found as attachment B to BOMA Interogatory #4: Ex. I-2-4; see also Ex. B-2-6, at pages 5 and 6.

[48] 2 Tr. 90.

[49] 2 Tr. 91.

[50] Ex. B-2-6, page 6. Enbridge's prefiled evidence about the cross bore issue in the 2010 rate adjustment case (EB-2009-0172) was filed at the hearing in this case as Ex. K2.6.

[51] See Ex. K2.6, for example at page 5 to 10. See also BOMA Interogatory #1 (Ex. I-2-1).

Agreement not to pursue that request. That agreement was expressly made without prejudice to Enbridge's right to request the same relief in 2011 or subsequent years.[52]

56. Enbridge's Sewer Safety Program has continued and evolved since 2010.[53] At the same time, as explained in the prefiled evidence[54], and in response to interrogatories[55], Enbridge has been participating in a number of industry initiatives to address appropriate responses to the identified dangers of cross bores. One such effort has been work on a Canadian Gas Association "White Paper" addressing cross bore risks (in 2010). Another of these activities has been efforts to educate and inform the Technical Standards and Safety Authority (TSSA).[56]

57. In August 2011, the TSSA issued its Directive, requiring gas distributors to create and implement an Action Plan to: mitigate the risk of creating new cross bores, raise stakeholder awareness of the dangers of cross bores when clearing sewers and to identify other potential risks and approaches to mitigate those risks. The TSSA Directive effectively makes it mandatory for all gas utilities in Ontario to undertake programs similar to Enbridge's Sewer Safety Program.[57]

58. In response to the TSSA Directive, Enbridge has filed its Sewer Safety Program Action Plan, setting out the activities that it plans to undertake to address the cross bore issue.[58]

59. As set out in Enbridge's prefiled evidence, it is the costs associated with the Action Plan that Enbridge seeks to recover as a Z factor in 2012. These costs relate to four categories of activity that are new since base rates were established for the IR term in 2007.[59]

---

[52] 2 Tr. 98-99.

[53] Ex. B-2-6, at page 6.

[54] Ex. B-2-6, at page 6.

[55] BOMA Interrogatories #4 and 6 (Ex. I-2-4 and 6)

[56] 2 Tr. 99.

[57] Ex. B-2-6, at pages 6 to 7. The TSSA Directive is found in Enbridge's evidence at Ex. B-2-6, App. A.

[58] The Action Plan is filed as Ex. B-2-6, App. B.

[59] Details of the activities and the forecast of associated costs are set out at pages 13 to 16 of Ex. B-2-6.

60. With that background, we turn to Enbridge's request that its forecast 2012 Sewer Safety Program costs be treated as a Z factor.

61. The evaluation of whether a matter qualifies as a Z factor must be measured against the stated criteria set out in Enbridge's IR Settlement. That Settlement Agreement was freely negotiated between all stakeholders, and approved by the Board.

62. There are five, and only five, criteria to be met to qualify for Z factor treatment.

63. Contrary to the implication raised through cross-examination[60], nowhere is there any requirement for the utility to be experiencing financial hardship, or earning less than its allowed rate of return, before a Z factor is approved. In Enbridge's submission, the Company's overall financial performance is not a relevant factor to consider here. That is made clear by the fact that parties agreed to a $1.5M Z factor threshold, in comparison to a distribution revenue requirement of around $950 million. Of course, Enbridge could never make a financial hardship case related to a $1.5M cost increase in relation to its overall revenue requirement. This underlines that parties never intended for the Company's overall financial health and results to be relevant to the evaluation of a Z factor request.

64. Similarly, the fact that Enbridge is entering the last year of its five year IR term, and will be able to include costs related to its Sewer Safety Program into base rates in 2013 is not relevant to Z factor eligibility in 2012.[61] The IR Settlement Agreement does not set a different test for Z factors in different years of the IR term.

65. Finally, the fact that Enbridge has not pursued Z factor treatment for the Sewer Safety Program in earlier years does not bear on whether the costs qualify for Z factor treatment in 2012, nor does the fact that Enbridge will (as required by the TSSA Directive) continue the Sewer Safety Program even if a Z factor is not approved.

66. Turning then to the five Z factor criteria that are set out in the IR Settlement Agreement, the evidence in this case demonstrates that each of these have been met in respect of Enbridge's 2012 forecast costs related to implementing its Sewer Safety Program.

---

[60] 2 Tr. 109-111.

[61] 2 Tr. 108.

a. *"The event must be causally related to an increase/decrease in cost"* :

Here, the Z factor event is the Company's understanding of cross bores as a real safety issue in its service areas, which was ultimately confirmed by the TSSA Directive.[62] Once Enbridge had identified cross bore issues as a real safety risk within its service areas (which happened after base rates for the IR term were set, as described above), the Company had no choice but to take steps to mitigate the risks. The new programs and initiatives developed and implemented by Enbridge in response to this newly identified issue have increased Enbridge's costs, as these are new activities not previously undertaken. These programs and initiatives are now mandatory, as a result of the TSSA Directive.

b. *"the cost must be beyond the control of the Company's management and is not a risk in respect of which a prudent utility would take risk mitigation steps"*

The costs associated with the Sewer Safety Program are not within the control of Enbridge's management. Having identified the safety issues associated with cross bores, it was appropriate and necessary for Enbridge to take steps to address and mitigate the associated risks. The Company's Sewer Safety Program began in 2009 and has evolved since that time as Enbridge's understanding of cross bore risks has matured. As of late 2011, the TSSA Directive has confirmed the mandatory nature of activities to address and mitigate cross bore risks. Throughout this period, the costs incurred by the Company were not "voluntary" or "controllable", but instead were necessary costs incurred (and to be incurred in 2012) to address cross bore safety issues. Stated differently, Enbridge has no discretion or control over its obligation to take steps and incur new costs to address identified safety issues that impact on the transmission, distribution and storage of gas. That the Company does not view these types of costs as "voluntary" is confirmed by the fact that Enbridge spent in excess of $3.5 million per year in 2010 and 2011[63] on the Sewer Safety Program, even when there was no recovery for that spending in rates. Of course, following the

[62] 2 Tr. 99.

[63] Ex. J2.3.

issuance of the TSSA Directive, there is no question that Enbridge has no choice but to incur costs in 2012 to carry out its Sewer Safety Program.

The second part of this Z factor criterion was established to ensure that the utility cannot claim a cost increase as a Z factor when that cost increase could have been avoided if the utility's past actions had been prudent.[64] In this case, Enbridge acted prudently and appropriately at all times in response to known information. Enbridge was the first Ontario gas utility to create and implement a program to address cross bore risks, which started in 2009, and its programs have evolved appropriately since that time. The Company's safety regulator (the TSSA) has acknowledged the importance of activities to address cross bore risks. As a result of the TSSA Directive, it is now mandatory for Ontario gas utilities to undertake programs such as Enbridge's Sewer Safety Program.

c. *"the cost increase must not otherwise be reflected in the per customer revenue cap"*

Enbridge's base rates for the IR term were established in early 2007, as part of the EB-2006-0034 proceeding. At that time, Enbridge was not aware of the risks associated with cross bores in its franchise areas. When looked at this way, the evidence is clear that Enbridge's base rates for the IR term do not include any amount for the activities that are part of the Sewer Safety Program. All costs are incremental.

d. *"any cost increase must be prudently incurred"*

It is clear that the cost increase (as compared to amounts contained within Enbridge's base rates from 2007) resulting from Enbridge's 2012 activities under its Sewer Safety Program will be prudently incurred. That is seen from the following facts:

- The activities contemplated by Enbridge's Sewer Safety Program are reasonable and necessary.

---

[64] As explained in response to Energy Probe Interrogatory #6: Ex. I-5-6, and at 2 Tr. 103-104.

- They are required to meet an identified safety risk.
- Undertaking activities of this nature is now mandatory, as required by the TSSA Directive.
- Finally, to the extent that the actual costs and associated revenue requirement are different from those forecast by Enbridge and recovered as a Z factor, the difference in revenue requirement will be recorded in a variance account, to be compared to and trued up against the amount of the Z factor. That true-up process will allow for the Board to be assured that the amounts that are different from what is forecast were prudently incurred.

e. *"the cost increase must meet the materiality threshold of $1.5 million annually per Z factor event (i.e. the sum of all individual items underlying the Z factor event"*

Enbridge's evidence sets out its forecast costs of approximately $5.8 million to implement the Sewer Safety Program for 2012.[65] The 2012 revenue requirement associated with that spending is $3.8 million, because some of the costs are capital in nature.[66] These amounts are clearly higher than the Z factor threshold. In any event, though, if Enbridge is permitted this Z factor, and then its revenue requirement turns out to be less than $1.5 million, then amounts collected in rates will be refunded at the time that Enbridge's 2012 deferral and variance accounts are cleared.

67. Finally, a couple of observations should be made in respect of the implementation of Enbridge's Z factor request. These comments relate to issues 14 and 17 in this proceeding.

68. As set out at issues 11 and 14 of the Settlement Agreement, all parties have agreed that if a Z factor is approved in this case then the recovery of the forecast costs will be reflected in final 2012 rates and implemented (into billing) in conjunction with a subsequent QRAM application.

---

[65] Ex. B-2-6, pages 12 to 16.

[66] Ex. B-2-6, App. C.

69. Enbridge's proposal is that its actual 2012 revenue requirement related to the Sewer Safety Program will be determined at the end of 2012 and recorded in a variance account (the "2012 CBCVA"). To the extent that the actual revenue requirement is different from the forecast revenue requirement recovered through the Z factor, then the difference will be trued up along with the clearance of Enbridge's other 2012 deferral and variance accounts.

70. This will act as a protection to ratepayers in two ways.

71. First, to the extent that Enbridge's actual 2012 revenue requirement is less than the $1.5 million Z factor threshold, then the entire amount will be refunded.

72. Second, assuming that the revenue requirement is in excess of the $1.5 million threshold, the use of the variance account, and subsequent true up will ensure that ratepayers will pay only the actual 2012 revenue requirement associated with the Sewer Safety Program.

73. In respect of issue 17, Enbridge's proposal is that the costs associated with this Z factor will be allocated in the same way as costs related to service laterals are currently allocated.[67]

74. Enbridge submits, therefore, that its 2012 Sewer Safety Program costs meet all of the Z factor criteria and it requests that the Board approve both the Z factor and the proposed variance account that would capture the difference between the estimated revenue requirement of $3.8M and the actual 2012 revenue requirement to address the cross bore risk.

All of which is respectfully submitted, February 3, 2012.

Fred D. Cass David Stevens

Counsel for Enbridge Gas Distribution Inc.

---

[67] The explanation behind this proposal is set out in response to Energy Probe Interrogatory #5(c), which is referenced as Ex. I-5-5 in this proceeding.