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By electronic filing

February 15, 2012

Kirsten Walli
Board Secretary
Ontario Energy Board
27th floor – 2300 Yonge Street
Toronto, ON M4P 1E4

Dear Ms Walli,

Enbridge Gas Distribution Inc.
2012 Rates Application
Board File No.: EB-2011-0277
Our File No.: 339583-000117

We are enclosing the Written Argument submitted on behalf of Canadian Manufacturers & Exporters ("CME").

The distribution of this Argument is taking place today rather than yesterday because of our wish to include therein comments on the submissions made by Board Staff. Based on the exchange that took place at the conclusion of the Oral Hearing, we understood that Board Staff would be circulating its submissions at least one (1) day prior to the Intervenor Argument filing deadline.

We raised this issue with counsel for Board Staff yesterday. Counsel advised that Board Staff's submissions would not be circulated until 4:00 p.m. on February 14, 2012. Counsel suggested that we file our submissions today with this letter of explanation.

We very much appreciate having had an additional day to complete our submissions.

Yours very truly,

Peter C.P. Thompson, Q.C.

PCT\slc
enclosure
c. Norm Ryckman (EGD)
Fred Cass (Aird & Berlis LLP)
Intervenors in EB-2011-0277
Paul Clipsham (CME)

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EB-2011-0277

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.

ARGUMENT OF
CANADIAN MANUFACTURERS & EXPORTERS ("CME")

February 14, 2012

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I N D E X

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I. INTRODUCTION

1. These are the submissions of Canadian Manufacturers & Exporters ("CME") with respect to the unresolved issues in the Application by Enbridge Gas Distribution Inc. ("EGD") for Ontario Energy Board ("OEB" or the "Board") approval of its rates for 2012.

II. GAS COSTS

2. In determining whether the total amount EGD proposes for 2012 Gas Costs is appropriate, we urge the Board to be guided by the principle that the increased cost consequences of gas supply contracts made by EGD in contravention of the express provisions of a Board approved Settlement Agreement are imprudent and should be disallowed.

3. We submit that, pursuant to the provisions of the System Integrity Settlement Agreement[1] (the "Settlement Agreement"), prior consultation by EGD with parties to that proceeding is a pre-requisite where any EGD proposed gas supply plan involves the acquisition of Short-Term Firm Transportation ("STFT") from TransCanada PipeLines Limited ("TCPL") in an amount greater than 200,000 GJ/day. We submit that the relevant provisions of the Settlement Agreement are contained under a topic heading entitled "Replacement of Peaking Supplies" and are as follows:

> ***"As part of its gas supply portfolio, Enbridge contracts for peaking supplies that are utilized in peak and near-peak conditions. Peaking supplies are pre-contracted arrangements for delivered supply to Enbridge's franchise area that it can call upon, typically on at least ten days during the winter season.***
>
> ***Enbridge will reduce the amount of peaking supplies held under contract as part of its gas supply portfolio by 200,000 GJ/day and it will replace these peaking supplies with an equivalent volume (200,000 GJ/day) of TCPL STFT service from Empress that it will secure annually, or, if economic, equivalent firm transportation. <u>The 200,000 GJ/day of STFT service contracted for annually by Enbridge will be for a period of three months (not limited to calendar months) over the winter throughout the term of the Long Term Resolution, unless otherwise agreed to by the parties or ordered by the Board</u>. …"*** (emphasis added)

[1] Exhibit I, Tab 6, Schedule 11.

4. In our submission, the foregoing provision is the portion of the Agreement that reflects EGD's obligation to consult with respect to any gas supply plan that involves more than 200,000 GJ/day of STFT. While the "Material Change in Circumstances" clause in the Agreement is another clause that can be considered, it is not the clause in the Agreement upon which we rely to demonstrate EGD's obligation to consult before increasing the STFT component of its gas supply mix beyond 200,000 GJ/day.

5. In the clause quoted above, the phrase "… unless otherwise agreed to by the parties or ordered by the Board …" at the very least requires EGD to consult with the parties and, failing agreement, to seek an order from the Board before it increases the STFT component of its gas supply mix above 200,000 GJ/day. We submit that the clause cannot be reasonably be interpreted otherwise.

6. It is in the context of the provision of the Agreement quoted above that the issue of whether EGD disregarded a commitment it made in the Board approved Settlement Agreement pertaining to increases in the STFT component of its gas supply mix is to be considered. This is the issue that we address in submissions that follow and we submit that this is the issue that must be determined, regardless of the debate between Board Staff and others pertaining to whether EGD's incremental STFT purchases constituted a material change in circumstances under that clause of the Agreement.[2]

7. The provisions in the Settlement Agreement cited above and others contained therein were premised on EGD's concerns about the ability of its system to meet its peak day obligations when a large portion of its peak day supplies were dependent upon third party peaking suppliers and direct shippers meeting their gas supply obligations during

[2] Board Staff, Industrial Gas Users Association ("IGUA") and Federation of Rental-housing Providers of Ontario ("FRPO") refer to this clause in their Arguments. IGUA and FRPO appear to indicate that EGD's incremental STFT purchases were material. Board Staff, who are not a party to the Agreement, suggests otherwise.

EGD's peak periods.[3] The "Long-Term Resolution" of these concerns was intended to endure beyond EGD's gas supply plan for 2010 and 2011.

8. No one is suggesting that the provisions of the Settlement Agreement require EGD to weigh or assess the views of a diverse range of stakeholders on the many elements of its gas supply and portfolio as EGD argues in paragraph 9 of its Argument-in-Chief ("AIC"). No one is suggesting that EGD is required to consult with parties to the Settlement Agreement in respect of every gas supply decision that can be seen to involve reliability of gas supply. No one is suggesting that EGD is obliged to consult before it puts together each and every gas supply portfolio to meet the annual, seasonal and peaking needs of its customers.[4] Moreover, no one is suggesting that the System Reliability proceeding should be re-opened as EGD argues in paragraph 14 of its AIC.

9. Rather, what we are suggesting is that, under the Settlement Agreement, prior consultation is a pre-requisite in a situation where the STFT element of any proposed gas supply plan involves the acquisition of an amount greater than 200,000 GJ/day. This is what the Settlement Agreement states and we submit that the Agreement cannot reasonably be interpreted otherwise.

10. The events that prompted EGD's decision to unilaterally increase its contracted 2011-2012 STFT from 200,000 GJ/day to 275,000 GJ/day included the very types of events that prompted the "Replacement of Peaking Supplies" provisions of the Settlement Agreement, namely, the failure of direct purchasers and a peaking supplier to meet their gas delivery obligations to EGD during peak periods in January and February 2011.[5]

11. The evidence before the Board is that EGD disregarded its "prior consultation" Settlement Agreement obligations.[6] We submit that the Board should not countenance

[3] Transcript Volume 1, page 61, line 14 to page 62, line 5, and EGD AIC, paragraph 7.
[4] EGD AIC, paragraph 9.
[5] EGD AIC, paragraph 7.
[6] Transcript Volume 1, page 65, line 3 to page 66, line 16; also see page 80, lines 5 to 13 where Mr. Somerville refers to the Board's support for a consultative process pertaining to matters related to system integrity.

EGD's failure to abide by those provisions in that Settlement Agreement. In the absence of the prior consultation contemplated by the Settlement Agreement, EGD cannot discharge the onus of establishing that the incremental cost consequences of acquiring 75,000 GJ/day of STFT in excess of the 200,000 GJ/day limit specified in the Settlement Agreement were prudently incurred. In these circumstances, we submit that the Board should impose the disallowance remedy that it considers to be appropriate.

12. In determining the appropriate disallowance remedy to impose, the Board should consider the amount by which EGD's total 2012 gas costs are higher as a result of its failure to adhere to the STFT 200,000 GJ/day limit specified in the Settlement Agreement. In that connection, the evidence indicates that, as a result of EGD's failure to adhere to the 200,000 GJ/day STFT limit, total gas costs are materially higher by a positive amount that is as much as $7.8M.[7] The evidence also indicates that the reduction in Third Party peaking supplies and the incremental 75,000 GJ/day of STFT provides EGD's owner with an opportunity to share in greater amounts of transactional services revenues.[8]

13. EGD declined to provide an estimate, other than the $7.8M, for the extent to which its total gas costs in 2012 are higher because of its acquisition of 75,000 GJ/day of STFT in excess of the 200,000 GJ/day limit specified in the Settlement Agreement.[9] In the absence of such evidence from EGD, we submit that the only finding open to the Board with respect to the amount by which gas costs are higher in 2012 as a result of EGD's actions in breach of the Settlement Agreement is the amount of $7.8M.

14. In these circumstances, we submit that the appropriate remedy is for the Board to disallow from EGD's total 2012 gas costs claim an amount of up to $7.8M. We submit that, in order to discourage future breaches of the provisions of a Board approved

[7] Exhibit J1.1.
[8] Transcript Volume 1, page 70, line 8 to page 72, line 12, and Exhibit I, Tab 8, Schedule 15, page 2.
[9] Transcript Volume 1, page 69, line 20 to page 70, line 7.

Settlement Agreement, the disallowance should be something more than a mere slap on the wrist. That said, we leave it to the Board to determine the appropriate amount of the disallowance.

15. If EGD plans to acquire more than 200,000 GJ/day of STFT in 2012/2013, then it should act promptly to comply with the "prior consultation" commitments it made in the Settlement Agreement with respect to the 200,000 GJ/day STFT component of its gas supply portfolio. The gas costs consequences of the acquisition of more than 200,000 GJ/day of STFT in 2013 can be considered for approval in 2013, provided EGD fulfills its prior consultation obligations under the Settlement Agreement.

III. PENSION FUNDING

16. The evidence reveals that the change in EGD's pension plan from a surplus position at the outset of the operation of the IRM Plan to a deficit position as of December 31, 2011, was caused by the combined effect of:

    (i) The decision of EGD's management to refrain from requiring contributions to the plan for a long period of time;

    (ii) The performance of pension assets largely influenced by financial market conditions, including interest rates; and

    (iii) The increase in pension liabilities caused because of low discount rates that are directly attributable to low yields on long term Canada Bonds.[10]

17. EGD's witnesses acknowledged that but for the very low interest rates, there would be no pension deficit at December 31, 2011.[11] Put another way, the primary proximate cause of the December 31, 2011 pension deficit is not the certificate filing requirement introduced by the Financial Services Commission of Ontario ("FSCO") in June 2009, as

[10] EGD AIC, paragraph 27.
[11] Transcript Volume 1, page 111, line 20 to page 112, line 1, and page 172, lines 3 to 8.

EGD contends,[12] but the very low interest rates that have prevailed during the course of the 5-year IRM Agreement that expires December 31, 2012.

18. In these circumstances, we submit that, in order for the estimated 2012 current services pension cost of $16.6M to qualify as a Z-factor, EGD must demonstrate that low interest rates constitute a Z-factor event pursuant to the provisions of the Z-factor criteria specified in the IRM Settlement Agreement. This is the issue that must be determined in the context of rate setting under the auspices of the IRM Agreement. The submissions of Board Staff fail to address this Z-factor eligibility issue which must be determined before any matters pertaining to the “sharing” of responsibility can be considered.[13]

19. In its Argument, Energy Probe Research Foundation (“Energy Probe”) correctly points out changes in interest rates are captured in the GDP IPI – FDD inflation factor in the escalator used to determine the per customer revenue cap in each year of the IRM Plan.[14] In this context, item (iii) of the Z-factor criteria, excluding cost changes reflected in the per customer revenue cap, precludes changes in interest rates from qualifying as a Z-factor.

20. On the other hand, if declines in interest rates do constitute a Z-factor event, as EGD argues,[15] then those declines constitute a Z-factor event for all other interest sensitive costs in EGD’s revenue requirements, except return on equity which is specifically not subject to adjustment under the provisions of the IRM Settlement Agreement. As Energy Probe points out in its Argument, there is no provision in the IRM Settlement Agreement that precludes adjustments to the costs of debt capital.[16] The statements of EGD’s witnesses to the effect that the wording of the cost of capital provisions of the IRM

[12] EGD AIC, paragraphs 20 and 21.
[13] Board Staff submissions, pages 6 to 8.
[14] Energy Probe Argument, page 5.
[15] EGD AIC, paragraphs 26 to 29.
[16] Energy Probe Argument, page 5.

Settlement Agreement precludes adjustments to the costs of debt are incorrect and without merit.

21. If lower debt costs attributable to lower interest rates are not Z-factors, then that situation can only result because declines in interest rates do not qualify as a Z-factor event. We reiterate that interest rate changes affecting debt and any other items of costs, except equity return, are not a Z-factor event because they are captured in the IRM Plan escalation formula.

22. EGD and its witnesses insist that reductions in EGD's costs of debt capital attributable to low interest rates are ineligible for Z-factor treatment.[17] From this, we can conclude that EGD and its witnesses accept that changes in interest rates do not constitute a Z-factor event. That a situation of low interest rates is not a Z-factor event deprives ratepayers of reductions in debt costs currently recoverable in rates of $21.7M in 2012 and an estimated cumulative amount of $63.5M[18] over the 5-year IRM period from 2008 to 2012 inclusive.

23. Over the period 2008 to 2011 inclusive, ratepayers have been prejudiced to the tune of about $41.8M[19] by the fact that, heretofore, a situation of low interest rates has never been regarded by any of the parties to the IRM Agreement or by the Board as a Z-factor event. Moreover, in addition to the fact that the escalation factor used to derive the per customer revenue cap covers changes in interest rates, the parties, by their conduct, during the course of the first 4 years of the operation of the IRM Agreement, have acknowledged that changes in interest rates are not a Z-factor event. In these circumstances, principles of contract law and estoppel should apply to preclude EGD from now claiming increases in costs attributable to low interest rates as an eligible Z-

[17] Transcript Volume 1, page 167, line 24 to page 169, line 4.
[18] Exhibit J1.9.
[19] Exhibit J1.9 – we calculate $41.8M to be the cumulative interest cost reductions for the years 2008 to 2011 inclusive.

factor in the last year of the 5-year IRM Agreement. It would be unfair in the extreme to find that low interest rates are a Z-factor for calculating EGD's pensions costs but not its debt costs.

24. In the alternative, if increases in current services pension costs caused by low interest rates are found by the Board to be recoverable from ratepayers, then, on fairness grounds, the cumulative reductions in debt costs attributable to low interest rates of $63.5M[20] should be credited to ratepayers. A situation of low interest rates either is or is not a Z-factor event. EGD cannot have it both ways.

25. Having regard to the facts that the IRM Plan escalator covers changes in interest rates and that the parties, by their conduct in prior years of the operation of the IRM Plan, have affectively acknowledged that changes in interest rates do not constitute a Z-factor event, we submit that the appropriate approach for the Board to follow in this case is to find that the 2012 current services pension cost does not qualify as a Z-factor.

26. The focus of these submissions is on the situation of low interest rates that EGD's witnesses acknowledged is the proximate cause for the December 31, 2011 pension deficit. That said, we agree with the submissions of Energy Probe, Building Owners and Managers Association of the Greater Toronto Area ("BOMA") and others to the effect that the other contributing factor to which EGD refers, being the decision of management taken years ago to refrain from requiring contributions from pension plan members, is not an event that qualifies as a Z-factor since it is a matter within the control of management and, in particular, within management's control of compensation costs. We support Energy Probe's submission to the effect that changes in compensation costs are covered by the per customer revenue cap and do not qualify as a Z-factor.[21]

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[20] Exhibit J1.9.
[21] Energy Probe Argument; pages 2 to 4, BOMA Argument, pages 9 to 13.

27. For all of these reasons, we submit that the current year's service cost of the pension plan, triggered as it is by changes in interest rates, is not a "archetypal" Z-factor as EGD contends. The cost does not qualify as a Z-factor. Since the expense does not qualify as a Z-factor, there is no need for the Board to consider EGD's related variance account request.

28. The issue of "sharing" that Board Staff raises[22] is not an item for determination in this case. It will be a matter for consideration in EGD's 2013 Rebasing case.

IV. PROPOSED DEFERRAL ACCOUNT FOR 2012 TRANSITION IMPACT OF ACCOUNTING CHANGES ("TIACDA")

29. We agree that the Board should refrain from establishing the requested 2012 TIACDA, at this time, and instead, consider all relevant aspects of the proposal in EGD's 2013 Rebasing case for all of the reasons outlined by Board Staff in their submissions[23] and in submissions made to a similar effect by others.

30. Another important reason for declining the 2012 TIACDA request and dealing with the matter later, in the 2013 Rebasing case, relates to the retroactive rate-making feature of EGD's 2012 TIACDA proposal that we describe in the paragraphs that follow.

31. We accept that EGD is required to move away from Canadian Generally Accepted Accounting Principles ("CGAAP") beginning January 1, 2012, and that its preference is to transition to United States Generally Accepted Accounting Principles ("USGAAP"), rather than Modified International Financial Reporting Standards ("MIFRS").

32. EGD moved to USGAAP on January 1, 2012, for corporate reporting purposes. That said, EGD's request for Board approval of its transition to USGAAP for regulatory purposes is a matter that will be considered and determined by the Board in EGD's 2013 Rebasing case.

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[22] Board Staff Argument, pages 7 and 8.
[23] Board Staff Argument, pages 13 to 16.

33. Although the 2012 TIACDA EGD proposes is extremely broad in scope, the only item that EGD can identify that in its view has a material 2012 accounting change impact is its unfunded liabilities with respect to Other Post-Employment Benefits ("OPEB").[24] We submit that the scope of any deferral account the Board considers now or later should be confined to those items that can be specifically identified as related to accounting changes. The Board should refrain from issuing an open ended deferral account of the type EGD proposes. The scope of any deferral account the Board considers should be confined to identifiable items related to accounting changes, which, in this case, are unfunded OPEB liabilities.

34. In their Arguments, Counsel for Board Staff and BOMA have provided a comprehensive description of the background circumstances giving rise to EGD's 2012 TIACDA request.[25] As we understand the evidence, EGD accounted for OPEB on a cash basis until the end of 2008. Accounting changes to CGAAP in 2008 required that EGD convert from the cash basis to the accrual method by 2009. At that time, rather than charging its unfunded OPEB liability on its Balance Sheet against earnings, EGD, without prior Board approval, recorded a "regulatory asset" in its Financial Statements as an "off-set" to match the OPEB liability on its Balance Sheet. For subsequent years under the IRM Plan, EGD continued to record a "regulatory asset" to off-set its unfunded OPEB liabilities. At the end of 2010, the "regulatory asset" recorded by EGD in its Financial Statements, without prior Board approval, amounted to $84M. At the end of 2011, the amount is expected to be $87M and at the end of 2012, approximately $90M.

35. We submit that an important point to recognize is that the accounting change that gives rise to the $87M of unfunded OPEB liabilities and the off-setting regulatory asset on EGD's 2011 Balance Sheet occurred not in 2012, but in 2008 and took effect in 2009.

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[24] Transcript Volume 2, page 75, line 17 to page 76, line 9.
[25] Board Staff Argument, pages 11 to 13; BOMA Argument, pages 16 to 19.

36. The 2012 TIACDA proposal that EGD makes in this case, along with the request to be permitted to record $90M therein, presumes that the unilateral actions it took in 2009 and repeated in 2010 and 2011 to establish a “regulatory asset” account to off-set its unfunded OPEB liabilities, all without prior Board approval, has already been approved by its regulator. The fact is that regulatory approval for these actions has neither been previously requested, nor granted. Of the $90M EGD seeks permission to record in the proposed 2012 TIACDA, $87M thereof stems from actions EGD took in prior years, for which it has obtained no regulatory approval.

37. We assume that EGD is now asking the Board to approve the actions it took in 2009 and repeated in 2010 and 2011 to unilaterally establish the regulatory asset to off-set its OPEB unfunded liabilities. We submit that without such an approval, the regulatory asset accounts that EGD established on its books for 2009, 2010 and 2011 have no validity for ratemaking purposes.

38. Before the Board can consider EGD’s 2012 TIACDA proposal, it must first consider, as a threshold issue, whether the actions EGD took in 2009 and repeated in 2010 and 2011 should be approved. This is the threshold “out of period” or retroactive ratemaking issue that is subsumed in the 2012 TIACDA request that EGD asks the Board to approve in this case.

39. The Board has traditionally refrained from even embarking upon a consideration of a request for rate relief that is “out of period” or retroactive. Requests for such relief are normally rejected in a summary fashion on grounds that they are “out of period” or constitute retroactive ratemaking.

40. If the Board applies that principle in this case, then it follows that $87M of the $90M that EGD seeks permission to record in its proposed 2012 TIACDA must be denied because those amounts stem from actions that occurred in 2009 and were repeated in 2010 and 2011 for which EGD failed to obtain timely regulatory approval.

41. On the other hand, even if the Board refrains from rejecting $87M of the $90M EGD seeks permission to record in its proposed 2012 TIACDA, on grounds that permitting those amounts to be recorded therein would constitute “out of period” or retroactive ratemaking, then the Board will need to determine whether the regulatory asset accounts EGD established for 2009, 2010 and 2011, without Board approval, should now be approved, and, if so, the amounts to be recorded therein with respect to the OPEB unfunded liabilities in 2009, 2010 and 2011.

42. In determining these questions, the Board will need to step back in time and consider the issues that EGD would have faced had EGD applied in a timely manner in its 2009 Rate case to establish a regulatory asset account pertaining to its unfunded OPEB liabilities and to record therein the full amount of those unfunded liabilities.

43. We submit that had EGD applied in a timely manner for the Board approvals it requires, it would have been faced with the burden of demonstrating under the IRM Plan that the recording of the OPEB unfunded liabilities as a charge against retained earnings was a Z-factor. We submit that the burden EGD faces is problematic because Z-factor eligibility only applies to an uncontrollable increase in <u>cost</u>. In this connection, EGD’s witness unequivocally acknowledged that the 2012 TIACDA that EGD asks the Board to approve is not needed to reflect any uncontrollable costs being incurred in 2012. It is solely being proposed for tracking purposes.[26] This evidence confirms that changes in financial reporting prompted by changes in accounting rules do not involve any uncontrollable increase in <u>costs</u>.

44. Put another way, the consequences of a change in accounting rules lie outside the ambit of Z-factor eligibility. This conclusion is confirmed by the fact that EGD is not seeking

[26] Transcript Volume 2, page 74, lines 14 to 24.

Z-factor relief with respect to unfunded liabilities; it seeks deferral account relief solely for tracking purposes.[27]

45. Even if EGD can persuade the Board to refrain from rejecting its requests for approval of the unilateral actions it took, without Board approval, in 2009, 2010 and 2011 on the grounds that they relate to "out of period" events, the evidence in this case strongly suggests that EGD may have considerable difficulty demonstrating that the amounts it recorded in the regulatory asset accounts in 2009, 2010 and 2011 qualify as Z-factors.

46. If EGD's unilateral creation of the regulatory asset accounts in 2009, 2010 and 2011 cannot be demonstrated to fall within the ambit of the Z-factor criteria under the IRM Agreement, then the unfunded liabilities in 2009 and the increments thereto in 2010 and 2011 would become a charge against earnings. In this context, they would erode the level of earnings and over-earnings being achieved by EGD under the IRM Agreement. The evidence in this case indicates that to December 31, 2011, the level of over-earnings being achieved by EGD under the IRM Agreement was about $77.5M.[28]

47. We submit that it should also be recognized that the effect of EGD's unilateral actions in 2009, 2010 and 2011 in creating and continuing the use of unapproved "regulatory asset" accounts to off-set the full amount of its unfunded OPEB liabilities was to insulate the earnings and over-earnings being achieved under the IRM Plan from exposure to unfunded OPEB liabilities by postponing a consideration of the appropriateness of creating a regulatory asset account to the end of the 5-year IRM Plan and to the cost of service rebasing proceeding following the termination of that Plan.

48. EGD's failure to provide the Board and interested parties with timely notice of the unfunded OPEB liabilities problem when it first occurred requires scrutiny. In a prior

[27] We disagree with counsel for School Energy Coalition ("SEC") that the $3M increment to unfunded OPEB liabilities in 2012 qualifies as a Z-factor. It does not. It is not an item of cost. It is an item that relates to accounting changes that lies outside the ambit of Z-factor coverage under the IRM Agreement. While not accepting that the amount is an item of cost that falls within the ambit of Z-factor criteria, we do agree with counsel for SEC that the 2012 increment to unfunded OPEB liabilities is $3M.

[28] Exhibit J2.4.

proceeding before this Board some years ago, EGD was criticized by the Board for failing to bring an unfunded liabilities problem to the Board's attention in a timely manner.[29] Matters pertaining to EGD's failure to bring the unfunded OPEB liabilities issue to the attention of the Board in its 2009, 2010 or 2011 Rate cases could influence the Board's response to the retroactivity issues subsumed in EGD's 2012 TIACDA proposal.

49. Full recovery from ratepayers of unfunded liabilities that had to be charged to retained earnings in 2009, 2010 and 2011 as a result of changes in accounting standards that occurred in 2008 should not be presumed to be automatic.

50. If the Board does not summarily reject EGD's proposal to record $87M of the $90M it proposes to record in its 2012 TIACDA, on grounds that those amounts stem from "out of period" transactions for which EGD has obtained no regulatory approval, and, instead, decides to embark on a consideration of the appropriateness of the actions EGD took in 2009 and repeated in 2010 and 2011, then the range of outcomes includes the following:

(a) No approval of EGD's actions in establishing the regulatory asset account;

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[29] In E.B.O. 179-14/15, in which Decision with Reasons issued on March 31, 1999, EGD, then named Enbridge Consumers Gas, presented an Application to the Board seeking certain approvals relating to the equipment rental program it then operated as an ancillary program to its distribution utility business. A feature of EGD's proposal was to recover from ratepayers a net amount of about $126.2M of unfunded deferred taxes pertaining to that program. These unfunded deferred taxes had been building up over the years, while the program was operated as an ancillary business to the utility. EGD had failed to bring these items of costs to the attention of the Board in a timely manner in the context of its utility rate cases that included the allocation of revenues and costs between the utility and its ancillary programs.

In the proceeding, EGD took the position that ratepayers are responsible for the rental program deferred taxes because prior decisions of the Board implied a commitment that the rental taxes would be recoverable in rates. In rejecting this contention and in holding EGD's shareholder responsible for the rental program deferred taxes, the Board criticized EGD for its failure to bring the unfunded liabilities problem to its attention in a timely manner. (See E.B.O. 17914/15, Decision with Reasons, March 31, 1999, at page 32)

The Board found the net unfunded liability of $126.2M to be the responsibility of the shareholder. The Board did establish a notional deferral account in an amount of up to $50M with draws on this account to be subject to Board approval.

At the end of the day, EGD's recovery from ratepayers of unfunded deferred taxes liabilities pertaining to the rental program were limited to $23.9M. The amount of the ultimate recovery was the subject matter of further decisions of the Board in RP-2002-0135 dated December 3, 2003, and RP-2003-0203 dated November 1, 2004, at pages 41 to 48. This case illustrates the point that the Board frowns on the actions of a utility in failing to bring to its attention in a timely manner problems related to ratepayer exposure to unfunded liabilities. The case also illustrates the point that full recovery from ratepayers of unfunded liabilities should not be presumed to be automatic.

(b) Approval for the account but with the amount to be recorded therein to be less than the full amount of the unfunded OPEB liabilities; or

(c) Approval of the account with the full amount of the unfunded liabilities to be recorded therein.

51. Based on the foregoing, we submit that the Board cannot proceed to consider the proposal for a 2012 TIACDA unless it either rejects the $87M of liabilities recorded in the regulatory asset EGD created in 2009 and continued in 2010 and 2011 on the grounds that that amount relates to unapproved “out of period” transactions, or embarks upon a full consideration of whether the actions EGD took in 2009, 2010 and 2011 should be approved and, if so, to what extent.

52. We submit that the retroactive ratemaking issue in this case is an important one that should be fully scrutinized in the Rebasing case. We submit that it is premature to determine the issue, at this time, without a full airing of all matters related to the “out of period” or retroactive ratemaking issue.

53. In argument, EGD relies on the Board’s recent Hydro One Networks Inc. (“Hydro One”) Decision approving an Impact for USGAAP Deferral Account to record the 2012 impact of differences between CGAAP and USGAAP. We agree with Board Staff that the Hydro One case is distinguishable on a number of facts that distinguish the relief requested by Hydro One in its case from the relief being requested by EGD in this case. First, the amounts to be recorded in the account were not identified by Hydro One in its proceeding. Second, Hydro One is not operating under the auspices of a multi-year IRM Plan. Third, there was no evidence in Hydro One’s case demonstrating that the accounting standard change giving rise to the costs that it seeks to record as 2012 accounting standard change costs in fact relate to accounting standard changes that became effective in 2009, rather than in 2012. Moreover, there was no evidence in Hydro One’s case that it had unilaterally and without prior Board approval recorded a

regulatory asset in its Financial Statements to off-set unfunded liabilities with respect to OPEB that existed as of December 31, 2009, and in years thereafter. For these reasons, we submit that the Board's Decision in the Hydro One case is not a precedent for granting the relief that EGD seeks in this proceeding.

54. EGD acknowledges that the deferral account it asks the Board to establish is merely for tracking purposes and that its establishment does not constitute any predetermination of recoverability. Moreover, EGD plans to seeks full recovery of unfunded OPEB liabilities in its 2013 Rebasing case if its request for deferral account approval in this proceeding is denied.[30] In these circumstances and having regard to all matters pertaining to the threshold retroactivity issue subsumed in EGD's 2012 TIACDA proposal, which are complex, we submit that the most appropriate course for the Board to adopt so as to avoid erroneous conclusions being adopted by third parties with respect to "entitlement" is to refrain from approving the requested deferral account, at this time, without prejudice to EGD's right to bring forward, in its 2013 Rebasing case, its request for recoverability in full from ratepayers of its unfunded OPEB liabilities.

55. The entire issue should be deferred to the 2013 Rebasing case. EGD's request for approval of its proposed 2012 TIACDA should be denied without prejudice to its rights to bring the matter forward for comprehensive scrutiny in its 2013 Rebasing case.

V. CROSS-BORE SAFETY PROGRAM

56. We agree with EGD that the issue to be determined is whether the facts support a finding that EGD's forecast 2012 revenue requirement of $3.8M related to its Cross-Bore/Sewer Safety Program qualifies as a Z-factor under the provisions of the IRM Settlement Agreement.[31] For reasons that follow, we submit that the answer to this question is clearly "NO".

[30] Transcript Volume 2, page 73, lines 3 to 18.
[31] EGD AIC, paragraph 41.

57. That the installation of gas lines using trenchless technology might result in a gas line being bored into a sewer line has been a known risk in the gas distribution industry for years.[32] Initially, EGD officials regarded this risk as an item that could be managed under the auspices of its prevailing plant damage procedures that fall within the ambit of its pipeline integrity program that has an overall 2012 O&M budget of almost $21M and a 2012 Capital budget of slightly more than $20M.[33]

58. The fact that sewers in EGD's franchise areas are installed at levels deeper than gas lines influenced EGD's initial risk mitigation approach to the Cross-Bore risk.[34] However, EGD's sensitivity to the known risk of Cross-Bores increased following an incident in 2004 experienced by its subsidiary, St. Lawrence Gas. That incident, and a "near miss" in one of EGD's franchises associated with a Cross-Bore, prompted EGD to increase its level of activity related to the mitigation of such risks.[35]

59. As a prudent utility, EGD is obliged to take pro-active steps to manage known risks related to the safety and integrity of its system. Pursuant to the second item in the Z-factor criteria, to which EGD refers at page 19 of its AIC, a cost incurred in relation to a risk, in respect of which a prudent utility <u>would take</u> risk mitigation steps is not Z-factor eligible. The phrase "<u>would take</u>" speaks to prospective and not past actions. Nevertheless, EGD, supported by Board Staff, argues that the Z-factor eligibility exclusion only applies to cost increases that could have been <u>avoided</u> if the utility's <u>past</u> actions had been prudent.[36] We submit that these submissions are without merit and should be rejected.

60. The Z-factor criterion does not read "… is not a cost related to a risk that could have been avoided if the utility's past actions had been prudent." Rather, it excludes Z-factor

32 Transcript Volume 2, page 96, line 15 to page 17, line 21.
33 Transcript Volume 2, page 94, line 27 to page 96, line 8; Exhibit J2.2.
34 EGD AIC, paragraph 50.
35 Transcript Volume 2, page 97, line 1 to page 98, line 28.
36 EGD AIC, paragraph 66(b) at page 20; Board Staff Argument, page 10.

eligibility for a cost related to "… a risk in respect of which a prudent utility would take risk mitigation steps."

61. There is no reference in the Z-factor criterion either to "avoided costs" or "past actions". We reiterate that the use of the phrase "would take" in the Z-factor criterion speaks to prospective and not past actions. The inclusion of that phrase and the absence of any reference to "avoided costs" in the criterion are incompatible with the interpretation that EGD and Board Staff postulate. For that interpretation to apply, the Z-factor criterion would have to be re-worded to apply to a cost incurred in relation to a risk in which a prudent utility would have taken risk mitigation steps. The interpretation EGD and Board Staff ascribe to the criterion is incorrect and should be rejected. To be Z-factor eligible, the cost must pertain to an external cause beyond the control of management that lies outside the ambit of activities in relation to a known risk in respect of which a prudent utility would take risk mitigation steps.

62. The risk of utility plant damage that stems from the clearing of plugged sewers containing a gas line Cross-Bore is no different than the risk of plant damage from any other third party intervention. The risk of third party damage to a utility plant from all known causes is something that all prudent utilities plan to mitigate.

63. In recognition of its obligation to take appropriate risk mitigation steps pertaining to the known Cross-Bore risk, and not because of any externally uncontrollable event, EGD's management directed that the level of its risk mitigation activities be increased.[37] In 2007 and 2008, EGD escalated its risk management activities to include more detailed investigations of the possible existence of Cross-Bores within its franchises.[38] By 2010,

[37] See for example, Exhibit J2.5 and the detailed instructions added to the Construction Manual in May 2007 following the Innisfil incident.
[38] EGD AIC, paragraph 52.

it had increased its level of Cross-Bore risk mitigation activities to the point of constituting them as a specific program entitled the “Sewer Lateral Initiative”.[39]

64. In 2010, EGD initially requested but withdrew its request for a Board determination that its increased costs associated with Cross-Bores constituted a Z-factor, even though the level of such costs had a revenue requirement impact that exceeded the Z-factor threshold of $1.5M.[40] In the following year, 2011, EGD’s forecasted costs associated with its increased level of activities related to Cross-Bores again exceeded the Z-factor threshold of $1.5M. Yet no Z-factor relief was requested. EGD’s conduct in refraining in prior years from pursuing Z-factor relief for costs related to Cross-Bores corroborates the conclusion that the costs do not qualify as a Z-factor.

65. Concurrently, EGD spearheaded industry initiatives that eventually led to the issuance of the TSSA Order in 2011, which EGD characterizes in its pre-filed evidence as the Z-factor event beyond its control that is causing the incurrence of Cross-Bore costs.

66. The reality is that the 2011 TSSA Order was not, in any way, a proximate cause for EGD’s incurrence of Cross-Bore costs. With or without the Order, EGD would be planning to incur these costs in 2012, just as it planned to incur them in 2007, 2008, 2009, 2010 and 2011. The pre-filed evidence contending that the TSSA Order constitutes a Z-factor event is without merit.

67. EGD now abandons the contention that the TSSA Order is the external uncontrollable event that supports a conclusion that its 2012 Cross-Bore costs qualify as a Z-factor. EGD now asserts that the Z-factor event is the enhancement of its understanding of Cross-Bore issues as a safety issue that occurred during the operation of the IRM Agreement.[41]

[39] Exhibit K2.6.
[40] Exhibit J2.3 – the revenue requirement for 2010 was $2.4M and for 2011, $2.7M.
[41] EGD AIC, paragraph 66(a) on page 20.

68. We submit that changes in the degree of EGD's comprehension of the scope of known system integrity risks is not an external factor beyond its control. Regardless of any changes in EGD's understanding of the Cross-Bore risk that may have occurred during the operation of the IRM Agreement, the increased levels of activity conducted by EGD with respect to Cross-Bores relate to a known risk, in respect of which a prudent utility would take risk mitigation steps. Costs associated with increases or declines in the level of activities a utility takes to manage known risks for which a prudent utility would take risk mitigation steps do not qualify as a Z-factor. Such cost changes, up or down, fall within the ambit of the spending coverage provided under the auspices of the IRM Plan.

69. EGD argues that Z-factor coverage is available because the Cross-Bore activities in which it plans to engage in 2012 are new and different from the Cross-Bore activities in which it engaged when base rates were established.[42] We question whether the nature of the activities have materially changed. The nature of the activities in which EGD is engaged over the years encompass investigation, prevention and remediation tasks. That said, it matters not that the changed level of activities include activities different from activities related to Cross-Bores reflected in base year rates. For the duration of the IRM Plan, the cost of all activities pertaining to risks known before the outset of the Plan and for which a prudent utility would take risk mitigation steps fall within the ambit of the spending coverage provided under the IRM Plan.

70. The evidence indicates that to December 31, 2011, EGD achieved cumulative over-earnings under the IRM Plan in an amount of about $77.5M.[43] Over the 5 years expiring December 31, 2012, the cumulative over-earnings are expected to be in an amount of about $58.8M.[44] Our reliance on this evidence of over-earnings is not for the purpose of suggesting that a demonstration of financial hardship is a pre-requisite to establishing

[42] EGD AIC, paragraph 54.
[43] Exhibit J2.4.
[44] Exhibit J2.4.

Z-factor eligibility.[45] Rather, the over-earnings evidence demonstrates that the IRM Plan provides more than adequate coverage for activities for which there is no Z-factor eligibility such as spending increases during the term of the Plan in relation to known risks and respect of which a prudent utility would take risk mitigation steps. Put another way, EGD's 5-year IRM Plan provided it with substantial "headroom" to accommodate Z-factor ineligible increases in spending plans related to known risks, in respect of which a prudent utility would take risk mitigation steps.

71. For all of these reasons, we submit that item 2 of the Z-factor criteria has not been satisfied. The Cross-Bore program costs in the amount of $3.8M do not qualify as a Z-factor. Since the costs do not qualify as a Z-factor, there is no need to consider EGD's related variance account proposal.

72. As already noted, the amounts embedded in EGD's 2012 Rates for pipeline system integrity expenditures are substantial, being budgeted at levels of almost $21M for O&M expenses and slightly more than $20M for Capital expenses. The extent to which these budgeted costs are contributing to the over-earnings realized by EGD under the auspices of its 5-year IRM Plan will be examined in EGD's 2013 Rebasing case. In EGD's 2013 Rebasing case, which will include all of its planned spending with respect to Cross-Bores and other items of expenditure, parties will be able to determine the extent to which total costs embedded in rates for all items of expenditure compare to the actual costs that EGD incurred over the IRM period on account of such items. The fact that the $3.8M of Cross-Bore costs that EGD seeks to recover from ratepayers are ineligible for Z-factor treatment in 2012 has no impact on EGD's planned spending for such activities in 2013. Rebasing will cover the costs of EGD's Cross-Bore programs for the years 2013 and beyond.

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[45] EGD AIC, paragraph 63.

VI. COSTS

73. CME requests that it be awarded 100% of its reasonably incurred costs in connection with this matter.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 14th day of February, 2012.

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