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February 24, 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") – Reply Argument
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 Reply Argument.

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.
REPLY ARGUMENT

A. Introduction

1. Enbridge Gas Distribution Inc. (Enbridge) submitted its argument in chief in this proceeding on February 3, 2012. In response to this argument in chief, Enbridge has received submissions from Board staff and from the Association of Power Producers of Ontario (APPrO), the Building Owners and Managers Association, Toronto (BOMA), the Consumers Council of Canada (CCC), Canadian Manufacturers & Exporters (CME), Energy Probe Research Foundation (Energy Probe), the Federation of Rental-housing Providers of Ontario (FRPO), Industrial Gas Users Association (IGUA), School Energy Coalition (SEC) and the Vulnerable Energy Consumers Coalition (VECC).

2. While all parties made submissions about the Z factors put forward by Enbridge, no objection was taken to either Z factor variance account proposed by Enbridge in the event that the Board accepts Enbridge's request in respect of the Z factor to which each account relates. Similarly, no objection was taken to the allocation of costs proposed by Enbridge in the event that the Board accepts either or both of Enbridge's Z factor requests. Accordingly, this leaves the following as outstanding issues for Reply Argument:
   (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); and
   (iv) Transition Impact of Accounting Changes Deferral Account (Issue 15).

B. Gas Cost & Carrying Cost

3. In addition to Board staff, only three parties – CME, FRPO and IGUA - made submissions on the gas costs issue. Energy Probe expressed its support for the position taken by CME and APPrO, BOMA, CCC, SEC and VECC made no submissions on the issue. Of the parties that made submissions on the gas costs issue (including Board staff), only one, CME, has asserted that the Board should not approve Enbridge's costs for the 2012 gas supply portfolio. CME contends that the Board should disallow an "amount of up to $7.8 million" from Enbridge's 2012 gas costs because "gas costs are higher in 2012" as a result of an alleged breach of the Settlement Agreement in EB-2010-0231 (the System Reliability Settlement Agreement).[1]

4. CME relies on provisions of the System Reliability Settlement Agreement with respect to 200,000 GJ/day of Short Term Firm Transportation (STFT) service that, according to the Agreement, Enbridge is to acquire from TransCanada PipeLines Limited (TCPL). In respect of this 200,000 GJ/day of STFT, the Agreement states as follows:

> 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.[2]

5. CME relies on the sentence from the System Reliability Settlement Agreement set out in paragraph 4 above to arrive at the conclusion that Enbridge is required "to consult with respect to any gas supply plan that involves more than 200,000 GJ/day of STFT".[3] This, however, is an extreme distortion of the words of the Settlement Agreement.

6. First, the sentence relied upon by CME says nothing about obligations of Enbridge in respect of "any gas supply plan that involves more than 200,000 GJ day of STFT". The plain words of the sentence indicate that it is referring to "The" 200,000 GJ/day of STFT that is referred to in the System Reliability Settlement Agreement. In respect of "The" 200,000

[1] Argument of Canadian Manufacturers & Exporters (CME Argument), page 4, paras. 13 and 14.

[2] EB-2010-0231 Settlement Agreement, page 9.

[3] CME Argument, page 2, para. 4.

GJ/day of STFT referred to in the Settlement Agreement, the sentence says that Enbridge will contract for this volume annually over a period of three winter months, and will continue to do so throughout the period of the Long Term Resolution, unless otherwise agreed to by the parties or ordered by the Board. As far as the 200,000 GJ/day of STFT is concerned, should Enbridge wish to change the practice of acquiring this service for three winter months during each year of the term of the Long Term Resolution, it would require either the agreement of parties or an order of the Board. That the sentence cited by CME relates to the timing of the months for which the additional peaking supplies are procured is also seen by the contrast between this sentence, and another provision of the System Reliability Settlement Agreement. The previous section of the System Reliability Settlement Agreement provides for Enbridge to acquire 50,000 GJ/day of STFT capacity for the specific months of November, December, January, February and March, to replace short haul capacity assigned to agents for mass market customers.[4] That clearly stands in contrast to the agreed-upon period of three non-specified winter months associated with the additional peaking supplies that is referenced in the sentence cited by CME.

7. The sentence relied upon by CME does not purport to create any requirement for agreement or approval in respect of other volumes of STFT that Enbridge may contract for as part of its annual gas supply portfolio. This is confirmed by Board staff, which says that it does not interpret the System Reliability Settlement Agreement as giving rise to a requirement that the 200,000 GJ/day of STFT be treated as a fixed amount that cannot be changed without parties' approval.[5]

8. Second, contrary to CME's assertion that Enbridge is required to consult with respect to any gas supply plan that involves more than 200,000 GJ/day of STFT, the sentence relied upon by CME says nothing about consultation. If, with respect to the 200,000 GJ/day of STFT referred to in the System Reliability Settlement Agreement, Enbridge wishes, during the term of the Long Term Resolution, to change the annual practice of contracting for this service for a period of three winter months, Enbridge can only do so with the approval of parties or with a Board order. The sentence relied upon by CME says that Enbridge must have one or the

[4] EB-2010-0231 Settlement Agreement, pages 6-9.

[5] Board Staff Submission, page 2.

other – agreement of the parties or a Board order – to change the annual practice, but it does not restrict Enbridge only to the option of proceeding by way of consultation with parties.

9. CME delayed the filing of its submissions in this proceeding for the express purpose of allowing it to include comments on the submissions made by Board staff.[6] In fact, CME's assertions on the gas costs issues are at odds with the submissions made by Board staff. In particular, CME states that: "No one is suggesting that EGD is obliged to consult before it pulls together each and every gas supply portfolio to meet the annual, seasonal and peaking needs of its customers".[7] Apparently, in CME's view, it is important that the Board understand that no one is even suggesting that Enbridge should have to consult with parties about the development of each gas supply portfolio - Enbridge agrees with the concerns that led CME to reassure the Board that there is not even a suggestion in this case that any such consultation is required.

10. As it happens, though, Board staff argues that Enbridge should consult with parties "during its planning process … **before** it files its annual gas supply plan for approval with the Board".[8] (Emphasis in original.) Also, FRPO's argument makes reference to "the annual consultations as outlined in Board staff submissions".[9] Enbridge reiterates the point made in argument in chief that it is neither practical nor reasonable to expect that it will consult with parties during the development of each gas supply portfolio.

11. After Enbridge's gas supply planning group has been provided with a volumetric forecast, it has only a limited window of time (typically less than one month) to develop the gas supply portfolio - including storage targets, peak day demand forecast and curtailment forecast - and then to develop the costs associated with the portfolio, before evidence with respect to the gas supply plan is filed with the Board. It is simply not practical to expect a process of consultation with intervenors during this time frame. Further, after the gas supply portfolio

[6] Covering letter accompanying CME Argument dated February 15, 2012.

[7] CME Argument, page 3, para. 8.

[8] Board Staff Submission, pages 5-6.

[9] Federation of Rental-housing Providers of Ontario Final Argument (FRPO Final Argument), pages 5-6, para. 10.

has been developed, Enbridge must make daily, weekly and monthly operating decisions with regard to gas supply options. The notion of consulting on the gas supply plan would mean either that operating decisions would cause Enbridge to depart from a plan that had been the subject of consultations or that it would have to reinitiate consultations to address any decisions that might be seen as not being fully in accordance with the plan. What is more, Enbridge submits, with all respect to the views of intervenors, that the gas supply planning process would in no way be enhanced by any such consultations, particularly when the others involved in the consultations would bear no responsibility for the risk of a system supply failure.

12. Contrary to CME's submissions about consultation, IGUA says that Enbridge was not required to consult with parties in respect of the 2012 supply portfolio change.[10] IGUA takes the position that Enbridge's responsibility under the System Reliability Settlement Agreement is to "report" to parties. IGUA goes on to acknowledge the evidence to the effect that the proportion of STFT held by Enbridge in 2012 is less than the proportion of STFT embedded in the System Reliability Settlement Agreement and it cites this "proportionate adherence" to the Settlement Agreement as one reason for not objecting to the incremental STFT costs underpinning Enbridge's 2012 gas supply portfolio.[11]

13. FRPO's argument is similar to that of IGUA and, like IGUA, FRPO does not suggest that the Board should disapprove of any of Enbridge's 2012 gas costs. All the same, FRPO contends that Enbridge did not fulfill its obligations under the System Reliability Settlement Agreement because Enbridge did not give notice to the Board or intervenors before contracting for 75,000 GJ/day of incremental STFT.[12] As the evidence indicates, Enbridge expected that it would need to meet incremental peak day demands during the winter of 2011-2012[13] and there are only two supply options available to it to meet incremental peak

[10] Industrial Gas Users Association Final Argument (IGUA Final Argument), page 3.

[11] IGUA Final Argument, page 3.

[12] FRPO Final Argument, page 4, para. 6. Note that FRPO states (page 2, para. 4) that the Long Term Resolution in the System Reliability Settlement Agreement "constituted an expectation of more than one winter", thereby implying that Enbridge has not continued with the Long Term Resolution beyond one winter. In fact, the evidence is clear that Enbridge has implemented all aspects of the Long Term Resolution and will continue to do so: 1 Tr. 28-29; 65-66.

[13] 1 Tr. 24.

day requirements, namely, long haul capacity (specifically, STFT) or peaking services.[14] No party has explained - in argument or otherwise - why Enbridge's decision to contract for additional STFT to meet incremental peak day requirements in 2012 triggers a responsibility to give notice to the parties to a proceeding that arose from an issue as to whether direct purchase bundled service customers should be required to contract for firm upstream transportation (the System Reliability Issue).[15]

14. Unfortunately, at the current time, STFT and peaking services are the only options available to Enbridge to address incremental peak day requirements and, further, Enbridge was driven to the decision that it should reduce its reliance on peaking services in 2012,[16] for reasons that have not been disputed by any party. It turns out, then, that STFT is an important option for Enbridge as it seeks to address incremental peaking needs and it is also an element of the Long Term Resolution of the System Reliability Issue addressed in EB-2010-0231. The fact that the limited options available to Enbridge cause STFT to be relied upon in different contexts[17] does not mean that a decision by Enbridge to contract for additional STFT to meet peaking needs gives rise to any obligations under the System Reliability Settlement Agreement.

15. Finally, in arguing that the Board should disallow some amount from Enbridge's 2012 gas costs, CME makes no effort to address the evidence indicating that the additional 75,000 GJ/day of STFT contracted for by Enbridge in 2012 is needed to meet seasonal as well as peaking needs[18] and is being utilized each and every day for seasonal purposes.[19] The evidence regarding the utilization of the additional STFT, including several quotations from

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[14] 1 Tr. 33.

[15] This is the "system reliability issue" that was the subject of the Long Term Resolution in the System Reliability Settlement Agreement: see Ex. I-6-11, p. 7, footnote 1 (EB-2010-0231, Ex. C-1-1, p. 3) and 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 page 6.

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

[17] 1 Tr. 65-66.

[18] 1 Tr. 27; 57-58.

[19] 1 Tr. 71.

oral testimony, was set out clearly in Enbridge's argument in chief[20] and no party has taken issue with this evidence. Enbridge submits that the distraction in this case arising from arguments made about the System Reliability Settlement Agreement does not in any way affect the key fact that the 75,000 GJ/day of STFT contracted for by Enbridge is needed as part of the 2012 gas supply portfolio.

C. Z Factors

(i) General submissions on Z factors.

16. Though the subject matters of Enbridge's two Z factor requests are different, the test to be applied to each is the same. The Z factor criteria to be used to evaluate Enbridge's requests are set out in the Board-approved Revised Incentive Regulation (IR) Settlement Agreement in EB-2007-0615.

17. Issue 6.1 of the Settlement Agreement asks "What are the criteria for establishing Z factors that should be included in the IR plan?". In response, there was a complete settlement which states that:

> "The Parties agree that 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."[21]

18. In large part, the intervenor arguments on the Z factor issues fail to directly address the Z factor criteria. Instead, the submissions introduce additional or restated criteria. Then,

[20] Enbridge Gas Distribution Inc. Argument in Chief (Enbridge Argument in Chief), pages 5-6, paras. 14-16.

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

having set out the additional or restated criteria, intervenor submissions set out the reasons why Enbridge has not satisfied those criteria.

19. Examples of places where intervenors have employed this technique are seen in arguments that:
    a. Z factor requests should be evaluated in light of the overall size of the Company's budgets or earnings.[22]
    b. Z factors cannot apply to activities that are part of a utility's ordinary course of business.[23]
    c. The requirement that any cost increases must be "beyond the control of Enbridge's management" means that any costs that result because management failed to make perfect decisions in earlier years (as judged now, with the benefit of hindsight) are ineligible.[24]

20. It is not appropriate to judge Enbridge's Z factor requests on the basis of supplementary criteria that are not found within the IR Settlement Agreement. All parties agreed to the listed criteria (as reproduced above), and they were approved by the Board. There has been no issue around these criteria for the first four years of Enbridge's five year IR term. Attempts to add additional criteria at this time should be rejected.

21. Intervenor arguments also misstate Enbridge's Z factor requests and then respond to why those misstated requests should be denied.

22. Examples of places where intervenors have employed this technique are seen in arguments that:

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[22] Final Argument of the Consumers Council of Canada (CCC Final Argument), pages 4-5; IGUA Final Argument, page 5; CME Argument, pages 20-21.

[23] IGUA Final Argument, page 4; Final Argument on Behalf of School Energy Coalition (SEC Final Argument), page 19; FRPO Final Argument, page 3.

[24] See, for example, Argument of Energy Probe Research Foundation (Energy Probe Argument), page 7; Argument of the Vulnerable Energy Consumers Coalition (VECC Argument), page 8, Building Owners and Managers Association, Toronto Argument (BOMA Argument), pages 9 to 13 and SEC Final Argument, page 10.

a. Enbridge is seeking Z factor relief for the financial consequences of changes in interest rates.[25]
b. Enbridge is seeking Z factor relief for increases in its overall employee compensation costs.[26]
c. Enbridge is relying solely upon the TSSA Directive as the Z factor event that has led to cross bore spending requirements.[27]

23. Of course, Enbridge's Z factor requests should be judged on the basis of the actual requests made, not on the restatements of those requests found in intervenor arguments. As set out in Enbridge's argument in chief, its Z factor requests for pension and cross bore funding fit properly within the scope of the Z factor criteria in the IR Settlement Agreement.

(ii) Pension Funding Z Factor

24. In argument in chief, Enbridge put forward the reasons for its position that the requirement to fund the current year's service costs of its pension plan is, in essence, an archetypal Z factor. In their efforts to avoid the conclusion that the 2012 pension costs meet the criteria for a Z factor under Enbridge's IR plan, intervenors that oppose the Z factor request have adopted a number of strategies.

25. One strategy attempted by opponents of the pension Z factor request is, first, to recharacterize Enbridge's proposal as something that it is not and, second, to argue against the proposal on the reconstituted basis. A number of intervenors, for example, have put forward arguments on the basis that Enbridge has requested a Z factor for changes in interest rates. This can be seen from CME's argument, where the apparent purpose of a series of paragraphs is to make the case that changes in interest rates do not qualify as a Z factor under the IR plan.[28]

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[25] See, for example, CME Argument, pages 6 to 8.

[26] See, for example. Energy Probe Argument, page 3.

[27] BOMA Argument, page 3; Energy Probe Argument, page 6.

[28] CME Argument, pages 6-8, paras. 19-23 and 25.

26. Enbridge has proposed a Z factor in respect of the requirement that it fund the current year's service cost of its pension plan; it has not proposed a Z factor to recover a change in interest costs. The Z factor criteria under the IR plan apply in respect of an "event" and, the "event" relied upon by Enbridge, again, is not a change in interest costs, but the requirement that Enbridge fund the service costs of the pension plan. Under the Z factor criteria, the "event" must be causally related to an increase/decrease in "cost" - the "cost" that Enbridge seeks to recover is not an interest cost, but pension plan service costs, which are future benefits earned by employees who are members of the plan.[29]

27. Enbridge's proposal has also been recharacterized as a claim in respect of "its total employee compensation package". Energy Probe argues that it is "ludicrous" for Enbridge to claim that its total employee compensation package is outside of management control.[30] Of course, Enbridge has not made a Z factor claim for a change in the cost of its total employee compensation package; it has made a Z factor request in respect of the requirement to fund pension plan service costs in 2012 and this requirement is beyond the control of management.

28. By recharacterizing the Z factor request as something other than it really is, intervenors aim to transform the request into a cost change that is outside the Z factor framework or that is within the control of management. It can readily be seen that, if this strategy of recharacterizing Enbridge's Z factor request were to prevail, intervenors would succeed in establishing a basis to refute any Z factor that otherwise would meet all of the applicable Z factor criteria.

29. If successful, this approach would essentially render the Z factor provisions of the IR plan meaningless. It is difficult to conceive of any cost increase falling squarely within the Z factor criteria that is not capable of being recharacterized in the manner suggested by intervenors in this case: the cost of an unexpected new requirement imposing a significant payroll burden on employers can be recharacterized as part of the total employee

[29] 1 Tr. 95.

[30] Energy Probe Argument, page 3.

compensation package; the cost of an extreme weather event causing damage and disruption to the distribution system can be recharacterized as part of the utility's management and operation of the system; and so on. In short, if Z factor requests can be recharacterized for the purposes of assessing the applicability of the Z factor criteria, it will always be possible to reframe a request in a way that falls outside of the criteria.

30. Another strategy emerging from intervenor arguments is to treat anything that relates to management activities as being within the control of management. CCC says that the administration of Enbridge's pension plan is clearly within the control of management, as is every other component of employee compensation.[31] SEC asserts that plan performance is entirely within management's control and the utility is expected to maintain its pension plan in a properly funded position and not let it get off-side.[32] It just simply is not correct to say that performance of a pension plan is entirely within management's control – this assertion is plainly contradicted by the evidence in this case that the financial position of most pension plans in Canada has declined significantly due to market conditions and that Enbridge's plan has been able to weather the storm better than most.[33] Intervenors make an unwarranted leap from the fact that administration of pension plans is a management activity to the proposition that performance of pension plans is within management control.

31. Yet another strategy adopted by intervenors who oppose the pension Z factor is to muddle the issue with a variety of theories of causation. BOMA says that the "proximate" cause of the pension funding requirement is a change in regulations, but that the "dominant" causes are a decline in interest rates and the performance of investments.[34] CME says that the "primary proximate" cause of the pension deficit is not the certificate filing requirement, but very low interest rates.[35] SEC embarks on a discussion of *causa sine qua non* and *causa causans* and gives a list of "examples of causes that ... meet the *causa sine qua non* test".[36]

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[31] CCC Argument, page 3, para. 10.

[32] SEC Final Argument, page 10, paras. 3.3.2 and 3.3.3.

[33] 1 Tr. 93.

[35] CME Argument, page 5, para. 17.

[36] SEC Final Argument, page 8, paras. 3.2.12-3.2.15.

32. Unfortunately, the theories of causation discussed in intervenor arguments do not take account of the applicable criteria for Z factors under Enbridge's IR plan. One of the criteria is that "the event must be causally related to an increase/decrease in cost". The criteria do not require that any particular event be a "proximate" cause, or a "dominant" cause, or a "primary proximate" cause or the *causa causans*. The criteria require that the "event" (in this case, the requirement that Enbridge fund the 2012 service costs of its pension plan) be "causally related" to an increase/decrease in costs.

33. Furthermore, the theories of causation discussed in intervenor arguments do not take account of the evidence in this case. The evidence is that, but for the requirement introduced in 2009 that Enbridge file an annual cost certification to justify continuation of a "contribution holiday", Enbridge's contribution holiday could have continued until the end of 2012 even with interim deficit positions.[37] As well, the evidence is that the change in the position of Enbridge's plan from a surplus to a deficit occurred for three reasons beyond the control of Enbridge.[38]

34. One of the reasons for the change from a surplus to a deficit was because contributions to the plan had not been required for a long time, even though annual service costs were incurred. In this regard, it is important to note that there are restrictions under income tax law that operated to prevent Enbridge from making contributions during the period of surplus.[39] Another reason for the change to a deficit was that the growth of pension assets had been unable to keep up with the growth of pension liabilities. In this regard, it is important to note that, even if interest rates and the performance of financial markets are a neutral factor, the surplus in a plan will erode over time by reason of incremental liability arising from employees continuing to earn benefits.[40] The final reason, also beyond the control of Enbridge, was the increase in pension liabilities due to the low discount rates used for the liabilities valuation.

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[37] 1 Tr. 94.

[38] 1 Tr. 93.

[39] 1 Tr.179

[40] 1 Tr.160

35. Enbridge submits that it is not helpful to the application of the Z factor criteria to sift through various factors that have some bearing on the requirement that Enbridge fund 2012 pension service costs in attempt to determine the "proximate" cause or the *causa causans*. It is enough to know – as the evidence clearly indicates – that the requirement to fund the service costs is "causally related" to an increase in cost and that "the cost" is beyond the control of Enbridge's management for all of the reasons given in the evidence.

36. In their efforts to seize upon a factor that they can describe as being within the control of Enbridge's management, intervenors have criticized the performance of plan investments. The intervenors who advance these criticisms, however, make no attempt to explain how their assertions can stand together with the uncontradicted evidence that Enbridge's pension plan has been able to "weather the storm" of recent financial conditions better than most plans. Moreover, these intervenors do not at any point recognize that the investment performance of pension plans must be assessed against plan-specific benchmarks and not against the results of different organizations that have different investment strategies and target asset allocations. As stated in Exhibit J1.6:

> The comparison against the benchmark returns is a more appropriate comparison than ... peer comparisons because it reflects the investment policy of the EGD fund, whereas the peer comparisons involve comparisons across plans with different asset mixes.[41]

37. In fact, the performance of Enbridge's pension plan investments has been shown to be good both when measured against the appropriate plan-specific benchmarks, and when benchmarked against a comparator group by BNY Mellon. The evidence in this regard is as follows:

> Over the ten year period ending December 31, 2011, the plan's investment performance was above the EGD benchmark and out-performed 75% of the BNY Mellon universe. This shows the strength of EGD pension plan investment performance over the long term.[42]

[41] Ex. J1.6, page 1.

[42] Ex. J1.6, page 2.

38. Before leaving this point about the performance of the plan, it should be noted that BOMA's argument contains statements that are not substantiated in the evidence. BOMA asserts, for example, that "the BNY client universe would have been largely US firms".[43] In fact, the BNY Mellon report states that "The Trust Universes are comprised of our observations from our substantial client base of Canadian fund sponsors."[44] BOMA also draws a comparison between the return of plan investments attributable to active management and the 0.5% administration and management fee.[45] It is incorrect for BOMA to assume that the factor used by Mercer to reflect active management in their valuation is the same as management's expectations or the targets provided to investment managers for the incremental returns expected to be achieved through active management. In addition, BOMA has overlooked the fact that the 0.5% includes both administration costs of the plan and investment management costs.

39. Another factor said by CCC to be within the control of Enbridge's management was the decision in 2001 to change the requirement for employees to contribute to the pension plan.[46] Of course, the change that occurred in 2001 was an established fact at the time when the parameters of Enbridge's IR plan were approved by the Board. The accrual of benefits for non-contributory service since 2001 has been at a lower rate than the accrual for contributory service prior to 2001,[47] so the change in the requirement for employee contributions has coincided with a lower rate of growth of liability for pension benefits than otherwise would have been the case. Further, the evidence is that, to change the plan now to require employee contributions would require amendments to the plan and negotiations in the collective bargaining process, with the result that any contributions from employees would have to be offset with a corresponding increment in some other element of employee compensation in order to maintain Enbridge's competitive position in the market place for hiring and retaining employees.[48]

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[43] BOMA Argument, page 11.

[44] Ex. J1.6, Attachment 2.

[45] BOMA Argument, page 12.

[46] CCC Argument, page 3, para. 10.

[47] Ex. B-2-5, Appendix B, page 28.

[48] 1 Tr.174-177.

40. In connection with their arguments about changes in interest rates, some intervenors have put forward calculations of amounts that they associate with particular implications of reduced rates.[49] However, interest rates seldom if ever remain unchanged over time and the effects of changes in interest rates flow through many elements of a utility's business in addition to the impacts that intervenors have chosen to "cherry pick" (to use a term appearing in intervenor arguments). While CME suggests that its argument about interest rates is based on what it calls "fairness grounds",[50] this so-called fairness argument ignores the benefits to ratepayers that have occurred due to the very large surplus position of Enbridge's pension plan before the start of IR. These arguments also ignore the fact that, through the earnings sharing mechanism in Enbridge's IR plan, ratepayers have been credited with half of the Company's savings resulting from changes in interest rates.

41. The evidence is that, because Enbridge's pension plan was in a surplus position at the time of the base year for the IR plan (2007), the costs during the term of the IR plan and the corresponding revenue requirement have not included any amounts relating to pension costs.[51] This has resulted in significant benefits to ratepayers both prior to and during the IR plan, which can be equated with the annual service cost averaging approximately $13 million per year. Over the past five years alone the benefit to ratepayers has been about $83 million.[52]

42. Enbridge respectfully requests a Z factor to allow recovery of the 2012 service costs of the pension plan that are expected to be about $16.6 million, as well as approval of a variance account to record any difference between the actual amount of pension service costs that must be paid in 2012 and $16.6 million. For all of the foregoing reasons, Enbridge submits that its request for a pension Z factor meets all of the applicable Z factor criteria and should be approved by the Board.

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[49] See, for example, CCC Argument, page 4, para. 4.

[50] CME Argument, page 8, para. 24.

[51] Ex. B-2-5, page 2, para. 7.

[52] Ex. B-2-5, pages 2-3, para. 7.

(iii) Cross Bore Z Factor

43. In argument in chief, Enbridge set out the factual context for its Z factor request to recover the $3.8 million revenue requirement for its 2012 cross bore safety program in rates. Along with this context, the Company also explained how its request was consistent with the five Z factor criteria set out in the IR Settlement Agreement.

44. In its submission, Board staff supports Enbridge's request. Among other things, Board staff notes that: "the actions of the Company in the years leading up to the 2011 TSSA requirement for an action plan demonstrate that its actions are prudent for a utility facing such a known safety risk" and that "[a]fter years of study, it is only relatively recently that the industry understands how to systematically tackle the issue. Now that the TSSA has launched its 2011 mitigation program, the costs of mitigation and hence the Z factor, has come to fruition in a formal sense before the Board. Board staff submits that these expenditures are not voluntary – rather they are both required and consistent with prudent utility practice in the presence of a known safety risk."[53]

45. Other stakeholders do not support Enbridge's request. Some of their objections are based on the Z factor criteria set out in the IR Settlement Agreement, and some are based on other items.

46. In respect of intervenor comments about the application of the stated Z factor criteria to the cross bore safety program, Enbridge has the following responses:

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

       Several parties appear to assume that Enbridge is relying solely upon the TSSA Directive as the Z factor event[54]. That is not Enbridge's position. As noted in argument in chief[55], the Z factor event here is the Company's understanding and recognition of cross bores as a real safety risk in its franchise areas, which was

[53] Board Staff Submissions, page 9 and 10.

[54] BOMA Argument, page 3; Energy Probe Argument, page 6.

[55] At para. 66(a).

ultimately confirmed by the TSSA Directive.[56] That Z factor event, which led to Enbridge initiating what has become its cross bore safety program, did not happen until after base rates were set in early 2007. As explained in testimony, it was not until mid 2007, when Enbridge encountered a cross bore at Innisfil (in its own franchise area), that Enbridge came to understand that cross bores could be an issue in Ontario. Enbridge had previously been thought that freeze/thaw issues in Ontario meant that sewer lines were installed at a different depth from gas lines, so that there was no real risk of intersection.[57] After the Innisfil incident, Enbridge immediately took steps to evaluate the potential dangers of cross bores in its franchise areas, including issuing a safety alert to contractors, and hiring an expert to study the situation.[58] The end result was the recognition of cross bores as real safety issue for Enbridge, which led to what is now called the cross bore safety program. Contrary to VECC's submission[59], it is not imprudent for Enbridge to have failed to recognize the dangers of cross bores at the time that pipes were installed using trenchless techniques. As noted in evidence, there are cost savings associated with trenchless installation of pipes,[60] meaning that ratepayers have benefitted from those construction techniques. The evidence in this case makes clear that gas utilities across North American have only recently come to realize the dangers associated with trenchless installation. There is no evidence of any cross bores being encountered or identified as a risk for Canadian utilities before the Innisfil incident in mid-2007. Following that incident, Enbridge was the first Canadian utility to recognize cross bore dangers in its own system, and has taken an industry-leading role in educating other utilities and the public about cross bore issues. The Company should not be criticized or penalized for doing so.

Once Enbridge had identified cross bore issues as a real safety risk within its service areas, the Company had no choice but to take steps to mitigate the risks. As

[56] 2 Tr. 99.

[57] 2 Tr. 90-91.

[58] 2 Tr. 117-121 and 123.

[59] VECC Argument, pages 7 and 8.

[60] Ex. B-2-6, page 3.

explained in argument in chief, this increased the Company's costs. For the most part, intervenors appear to support the Company's steps to implement its sewer safety program.[61] No intervenor suggests that the sewer safety program is inappropriate or unnecessary. Of course, as recognized by Board Staff[62], these programs and initiatives are now mandatory, as a result of the TSSA Directive. Stated differently, if Enbridge did not already have a sewer safety program before the TSSA Directive, then it would have been required to put such a program into place for 2012.

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"

There are two aspects to this criterion.

First, the costs must be "beyond the control of the Company's management". In this case, there is little question that the 2012 costs are beyond Enbridge's control, as the TSSA Directive mandates activities in response to the cross bore risk. Intervenors suggest, however, that Enbridge must have control over the costs, because the Company was already undertaking the cross bore safety program before the TSSA Directive.[63] Enbridge takes a different view. As stated already, once Enbridge became aware of the applicability and magnitude of the cross bore danger in its franchise areas, it had no choice but to react. For the most part, intervenors do not appear to disagree, given the lack of objection to the cross bore safety program itself.

The second aspect of this Z factor criterion is that "the cost ... is not a risk in respect of which a prudent utility would take risk mitigation steps". Admittedly, this phrasing is difficult to decipher. As noted in argument in chief, Enbridge understands this phrase to mean 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

[61] See for example, SEC Final Argument, page 19 and VECC Argument, page 9.

[62] Board Staff Submissions, page 10.

[63] See, for example, BOMA Argument, page 3.

prudent.[64] That is logical, as it disentitles the utility from acting imprudently and then later claiming that subsequent events caused it to incur costs that should have been spent earlier. In response to this position, CME urges the Board to adopt a different meaning of this phrase, focused on the words "would take". CME appears to suggest the phrase to mean that a Z factor is not appropriate for any costs that a utility must incur once it identifies a risk (or at least in relation to a "known risk").[65] That interpretation, which focuses on risks, rather than costs, does not make sense. It would mean that once Enbridge came to understand a risk, then any amounts spent in response could not qualify as a Z factor. That would effectively disqualify any risk-responsive spending from Z factor treatment, regardless of the circumstances. The Company does not believe that to be the intent of this Z factor criterion.[66]

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

As explained in argument in chief, Enbridge's base rates for the IR term were established in early 2007, as part of the EB-2006-0034 proceeding. At that time, before the incident at Innisfil, Enbridge had considered that there were no real risks associated with cross bores in its franchise areas.[67] Thus, contrary to the arguments of many intervenors[68], cross bores were not a "known risk" to Enbridge at the time that base rates were set.

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

[65] CME Argument, pages 17 and 18. It should be noted that after taking Enbridge and Board Staff to task for departing from the literal wording of this Z factor criterion, CME proceeds to do the same thing, by rewriting the phrase to read "to be Z factor eligible, the cost must pertain to an external cause beyond the control of management that lies outside of the ambit of activities in relation to a known risk in respect of which a prudent utility would take risk mitigation steps." CME's wording introduces new concepts such as "external cause", "outside the ambit of activities" and "known risks", none of which can be found in the wording of the IR Settlement Agreement.

[66] CME's apparent position stands in contrast to the interpretation of Z factor requirements for electricity distributors under their IR regime, as seen in a 2009 case where Toronto Hydro was allowed Z factor treatment for costs related to addressing contact voltage occurrences. In that case, recovery of costs as a Z factor was allowed, in part because it was determined that Toronto Hydro had not acted imprudently prior to the identification of the safety issue. (EB-2009-0243, Decision dated December 10, 2009, at pp. 6 and 7).

[67] Argument in chief, at para. 66(c) and 2 Tr. 90-91.

[68] See, for example, CME Argument, page 20.

As a result, the costs associated with the cross bore safety program are not part of Enbridge's base rates for the IR term. While some intervenors take Enbridge to task for not having fully appreciated the cross bore dangers in its franchise area at an earlier date[69], the fact is that base rates would likely have been higher if this issue had been understood at the time that base rates were set. It is opportunistic to now state, on the one hand, that Enbridge should have acted earlier (in which case, base rates would have been higher for the full IR term), while on the other hand benefitting from the lower rates and stating that costs of this nature can never be recovered as a Z factor.

d. "any cost increase must be prudently incurred"

No intervenor has taken issue with the prudence of Enbridge's proposed cross bore safety program activities or the forecast associated costs. It is agreed that the revenue requirement associated with the actual costs incurred will be tracked in a variance account, so that Enbridge does not over or under-recover.

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"

No intervenor has asserted that the revenue requirement associated with Enbridge's 2012 cross bore safety program is likely to be less than the $1.5 million threshold. In any event though, as explained in argument in chief, if the revenue requirement does not exceed the threshold then all Z factor amounts collected in rates will be refunded.

47. Enbridge also has responses to a number of the additional arguments raised by intervenors, beyond the listed Z factor criteria.

48. Several intervenors argue that Z factors are not intended to apply to pipeline integrity activities, or the things that a gas distributor does on a day to day basis.[70] Following from the above, intervenors also argue that Enbridge's request should be evaluated in relation to

[69] Energy Probe Argument, page 7 and VECC Argument, pages 8 to 9.

[70] See, for example, SEC Final Argument, page 19; CCC Final Argument, page 2; CME Argument, page 21; and IGUA Argument, page 4.

the overall budget for system integrity activities.[71] These criteria are not included in the IR Settlement Agreement. What is required is that the costs must not be part of existing rates, which would mean that the underlying activities would not be part of the utility's day to day activities at the time that base rates were set. The costs at issue here were not part of base rates, and were not part of the budgets (or the pre-2007 pipeline integrity activities) that underlie base rates. The fact is that the Z factor event (the recognition of cross bores as a real safety risk in Enbridge's franchise areas) has added to the Company's day to day system integrity activities, and has added costs in excess of the Z factor threshold. That should qualify these costs for Z factor treatment, when the criteria from the IR Settlement Agreement are applied.

49. A number of intervenors also assert that the Board should take Enbridge's earnings through the IR term into account when considering the Z factor request.[72] The suggestion is that Enbridge has "headroom" to accommodate cost increases. That is not the test. The IR Settlement Agreement provides that Enbridge is entitled to Z factor treatment if it satisfies the listed criteria. If Enbridge is "overearning", then ratepayers benefit through the earnings sharing mechanism.

50. In its Argument, CME notes that Enbridge has not pursued Z factor relief in 2010 and 2011 for cross bore safety program costs, and this "corroborates the conclusion that the costs do not qualify as a Z-factor".[73] Enbridge disagrees. There is no obligation on Enbridge to pursue Z factor relief for any item in any particular year. Although the Company may have decided not to pursue a Z factor in prior years, and to absorb the cross bore safety program costs, that has no bearing on this 2012 application. While ratepayers have benefitted over the past several years from Enbridge's decision not to seek to pass on the cross bore safety

[71] See, for example, CCC Final Argument, page 2; and Energy Probe Argument, page 7. CME suggests that Enbridge initially thought that it could accommodate the cross bore safety program costs within the pipeline integrity budget (see CME Argument, page 17) – there is no evidence to support such an assertion – the evidence provided by Enbridge speaks only to the size of the pipeline integrity budget, and makes clear that the cross bore safety program costs were not part of that budget when base rates were established.

[72] See, for example, CME Argument, page 20 and 21 and IGUA Argument, page 5.

[73] CME Argument, page 19.

program costs in rates, the Company believes that it is appropriate that the costs be included in rates for 2012.

51. Finally, VECC asserts that if Enbridge is permitted Z factor relief, then costs related to "Legacy Investigations" should be excluded because that activity is not directly related to addressing the risk associated with blocked sewers.[74] The Company does not agree. The "Legacy Investigation" activity is part of the Company's overall plan to reduce the risks posed by cross bores. As explained in testimony, Enbridge is focusing its legacy investigations in a targeted way on areas where cross bores have been found, as that is a strong indicator of where there may be additional cross bores.[75] The goal of this activity is to locate and remove cross bores, and thereby reduce potential dangers to homeowners and the public. This activity is part of the "Action Plan" that was mandated by the TSSA.

52. VECC also asserts that Enbridge's costs related to the public awareness and response campaign should be capped at the budgeted amount of $300,000.[76] Enbridge does not believe that there is any evidentiary basis for such a limit. These costs are part of the Company's cross bore safety plan, and are necessary to increase awareness of the potential dangers of clearing blocked sewer lines without confirming the location of gas lines. Enbridge will act prudently in determining what public awareness expenditures are necessary, but it is not appropriate to preemptively limit the amount of such spending.

53. In all of these circumstances, Enbridge submits that its request for a cross bore safety plan costs Z factor meets all of the applicable Z factor criteria and should be approved by the Board.

D. Transition Impact of Accounting Changes Deferral Account

54. Three parties that filed arguments in this case - APPrO, FRPO and IGUA - did not make any submissions in response to Enbridge's proposal to establish the Transition Impact of Accounting Changes Deferral Account (TIACDA). The submissions by other parties with

[74] VECC Argument, page 10 and 11.

[75] 2 Tr. 136.

[76] VECC Argument, page 11.

respect to the TIACDA range from relatively short and straightforward comments (CCC and Energy Probe) to lengthy and detailed discussions of the issue (BOMA, CME and SEC).

55. CCC states that it is not opposed to the establishment of the TIACDA, if, in fact, the account is needed for regulatory purposes.[77] Similarly, Energy Probe does not oppose the creation of the TIACDA, although it says that the account is essentially needed to track differences and that Enbridge has confirmed that it is not necessary to have a deferral account to track differences.[78] As for any question arising from the arguments of CCC and Energy Probe about whether the TIACDA is needed, Enbridge submits that the reasons for establishing the account are confirmed by the arguments of other parties. This will be seen from the submissions that follow.

56. CME devotes almost eight pages of argument to the TIACDA before landing on the conclusion that "[t]he entire issue should be deferred to the 2013 Rebasing case".[79] CME says that the most appropriate course for the Board is to refrain from approving the TIACDA "so as to avoid erroneous conclusions being adopted by third parties with respect to 'entitlement'".[80] The fact is, though, that Enbridge has made clear that it is seeking no indication in this case about recoverability of amounts recorded in the TIACDA[81] and the Board can approve the TIACDA with an express and unequivocal stipulation that the approval of the account does not imply or presume any outcome with respect to the disposition of the account. There would be no prejudice to anyone arising from the establishment of the TIACDA subject to this express stipulation and there would be no basis for anyone to form erroneous conclusions about "entitlement".

57. In its submissions, CME asserts that there is an "out of period" or retroactive ratemaking issue that is "subsumed" in Enbridge's request for approval of the establishment of the TIACDA.[82] These submissions echo arguments by SEC about retroactive ratemaking.[83]

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[77] CCC Final Argument, page 5, para. 18.

[78] Energy Probe Argument, page 8.

[79] CME Argument, page 16, para. 55.

[80] CME Argument, page 16, para. 54.

[81] 2 Tr. 5.

[82] CME Argument, page 11, paras. 37-38

However, Enbridge's transition away from Canadian Generally Accepted Accounting Principles (Canadian GAAP) in 2012 does not give rise to issues about retroactive ratemaking in the context of this 2012 rate adjustment proceeding.

58. Enbridge was required to transition away from Canadian GAAP for financial reporting purposes as of January 1, 2012. Because of the transition away from Canadian GAAP - and regardless of whether Enbridge were to move to United States Generally Accepted Accounting Principles (U.S. GAAP) or International Financial Reporting Standards (IFRS) - Enbridge can no longer retain the asset or offset account for Other Post Employment Benefits (OPEBs) that resulted in a net expense for OPEBs for financial reporting purposes equivalent to the expense under the cash basis of accounting used for regulatory purposes. The impact of the requirement to move away from Canadian GAAP for financial reporting purposes occurs in 2012 and it is in no way retroactive ratemaking for that impact to be recorded in a 2012 deferral account.

59. Enbridge disagrees completely with the notion that the impact of a required move away from Canadian GAAP gives rise to an issue of retroactive ratemaking. However, if intervenors actually do believe that issues about "out of period" or retroactive ratemaking arise in the very year when the impact of the required change occurs (2012), then this confirms that there is every reason for Enbridge to have been concerned about the retroactivity arguments that would have been made in the 2013 case had Enbridge not sought a deferral account in 2012. The establishment of the deferral account in the year in which the impact occurs is appropriate to preserve the positions and arguments of parties as they exist at that time, so that no party is prejudiced when disposition of the amount recorded in the account is considered in a future case.

60. Moreover, because Enbridge was required to move away from Canadian GAAP for financial reporting purposes as of January 1, 2012, the establishment of the TIACDA in 2012 facilitates a matching between financial and regulatory accounting, it is advantageous from

[83] SEC Final Argument, pages 13-16, paras. 4.2.11-4.2.25.

the point of view of earnings volatility and it improves transparency and comparability when financial accounting results are looked at opposite regulatory results.[84]

61. In short, there are a number of reasons that support approval of the TIACDA and no party has identified any prejudice that will be caused if the account is approved with the express stipulation that approval does not presume or imply any outcome with respect to disposition of the account. While Board staff's submissions refer to the Addendum to Report of the Board on Implementing IFRS in an Incentive Rate Mechanism Environment,[85] the following comments were made by the Board in that Report about establishment of an OPEB-related account:

> The Board will not approve the creation of a generic account for IFRS related impacts on P&OPEB accounts occurring at the date of transition. … the impacts are anticipated to be significant for only a few large utilities. The option remains for these utilities to seek an individual account if they can demonstrate the likelihood of a large cost impact upon transition to IFRS.[86] (Emphasis added.)

Later, the Addendum indicates that utilities filing and reporting under USGAAP generally should read references to IFRS in the Addendum to include USGAAP.[87] As well, it is important to note that the Board's comments about OPEB-related accounts were made specifically in the context of a document dealing with implementation of IFRS in an Incentive Regulation environment.

62. Given the existence of valid reasons for approval of the account and the lack of any prejudice arising from this result, Enbridge respectfully submits that the TIACDA should be established.

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[84] 2 Tr. 42.

[85] Board Staff Submission, page 15.

[86] Addendum to Report of the Board on Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment (Addendum), EB-2008-0408, June 13, 2011, page 15.

[87] Addendum, page 34.

All of which is respectfully submitted, February 24, 2012.

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