

Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

Commission de l'énergie de l'Ontario
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone; 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273



BY EMAIL

April 27, 2012

Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Walli:

**Re: Enbridge Gas Distribution Inc.
2013 Rates Application
Board File No. EB-2011-0354**

Dear Ms. Walli:

Please see attached the Board Staff Submission relating to the Preliminary Issue in the above proceeding. The document is being forwarded to all intervenors in this proceeding.

Yours truly,

[original signed by]

Colin Schuch
Case Manager

cc: all intervenors

/ attach.



ONTARIO ENERGY BOARD

BOARD STAFF SUBMISSION

Enbridge Gas Distribution Inc.

2013 Rates Application

Board File No. EB-2011-0354

April 27, 2012

Introduction

Enbridge Gas Distribution Inc. (“Enbridge” or the “Applicant”) filed an application on January 31, 2012 (the “Application”) with the Ontario Energy Board (the “Board”) under section 36 of the *Ontario Energy Board Act, 1998*, S.O. c.15, Schedule B for an order of the Board approving or fixing rates for the sale, distribution, transmission and storage of natural gas, commencing January 1, 2013. The Board assigned file number EB-2011-0354 to the Application and issued a Notice of Application dated March 2, 2012 (the “Notice”). The Application was filed on the basis of US Generally Accepted Accounting Principles (“USGAAP”).

The Board issued its Procedural Order No. 1 on March 29, 2012, which established the approved list of intervenors for this proceeding. In addition, Procedural Order No.1 recognized the need for the Board’s determination on Enbridge’s request for the adoption of USGAAP for regulatory purposes (the “Preliminary Issue”) in accordance with the *Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment* (the “Addendum Report”). Procedural Order No.1 also identified the Preliminary Issue as follows:

Is it appropriate to establish USGAAP as the approved accounting standard for rate setting, regulatory accounting and regulatory reporting purposes commencing January 1, 2013? (the “Preliminary Issue”)

With respect to the Preliminary Issue, the Board set a timeline for interrogatories, interrogatory responses, submissions, and Enbridge’s reply submission to take place in advance of further procedural steps in the proceeding. In addition, the Board adopted all evidence relevant to the transition to USGAAP from Enbridge’s Incentive Regulation Plan (“IR Plan”) 2012 rate adjustment proceeding under Board file number EB-2011-0277 as evidence in this proceeding.

Preliminary Issue – USGAAP Transition

Background

The Addendum Report noted that the Board must consider the general public interest in ensuring efficiency and consistency in utility regulation in Ontario, and will require utilities to explain the use of an accounting standard other than Modified International

Financial Reporting Standards (“MIFRS”) for regulatory purposes. These requirements are stated as follows:

The Board requires a utility that adopts USGAAP or an alternate accounting standard other than IFRS, in its first cost of service application following the adoption of the new accounting standard, to:

- demonstrate the eligibility of the utility under the relevant securities legislation to report financial information using that standard;
- include a copy of the authorization to use the standard from the appropriate Canadian securities regulator (if applicable); and
- set out the benefits and potential disadvantages to the utility and its ratepayers of using the alternate accounting standard for rate regulation.¹

Submission

Eligibility under the Relevant Securities Legislation and Required Copy of Authorization to Use the Standard

Enbridge has provided the decision issued by the Alberta Securities Commission approving the use of USGAAP by Enbridge in multiple jurisdictions (Alberta and Ontario) for financial reporting purposes. The decision was granted for a period of three years, spanning Enbridge’s financial year commencing January 1, 2012 until the financial year ending December 31, 2014. Board staff submits that Enbridge has demonstrated the required eligibility under the relevant securities legislation, and has filed the required copy of the authorization to use USGAAP from the securities regulator.

Benefits and Potential Disadvantages

Board staff submits that Enbridge’s evidence supports the use of USGAAP for regulatory purposes and its proposal is in the best interests of the utility and its ratepayers.

¹ *Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment*, p. 33.

Benefits to the Utility and Ratepayers:

Enbridge stated that the advantages of adopting USGAAP over MIFRS include: alignment between financial reporting and regulatory accounting; transparency; ease of reconciliations; more reflective of the economic realities of regulated operations; greater consistency between earnings and revenue requirements; facilitates industry comparability, reduced regulatory costs, and reduced revenue requirement.²

Board staff notes that the two most relevant benefits for ratepayers are:

- 1) Reduction of 2013 revenue requirement of \$54 million³ by using USGAAP in place of MIFRS;
- 2) Consistency in earnings and revenue requirements.⁴

Enbridge's evidence pointed to a potentially significant impact should it adopt MIFRS. If Enbridge was to adopt MIFRS, the largest contributing factor to the increased revenue requirement is the level of costs which would be required to be recognized as current operating costs versus being able to be capitalized. This level of current operating costs was quantified by Enbridge to be approximately \$42.5 million⁵. These costs are mostly indirect administrative and general overhead costs and pre-construction project costs which under Canadian Generally Accepted Accounting Principles ("CGAAP") and USGAAP are permitted to be capitalized, versus being considered an expense under IFRS.

Enbridge confirmed that there would be no impact on its proposed 2013 revenue requirement as a result of moving to USGAAP from CGAAP with respect to Enbridge's capitalization policies.⁶

With the exception of the impact of other post-employment benefits ("OPEB"), Enbridge stated that it did not expect any other significant impact to rates as a result of using USGAAP versus CGAAP.⁷ Enbridge declared that under USGAAP, Enbridge is

² Enbridge ExhA1/T6/S2/p5

³ Enbridge Response to Board Staff Interrogatory #3 ExhI/Sch1.3/p1

⁴ Enbridge ExhA1/T6/S2/p5

⁵ Enbridge Response to Board Staff Interrogatory #3 ExhI/Sch1.3/p1

⁶ Enbridge Response to Board Staff Interrogatory #3 ExhI/Sch1.3/p1

⁷ Enbridge Response to Board Staff Interrogatory #2 ExhI/Sch1.2/p1

required to record OPEB on an accrual basis versus the previously allowed cash basis. Enbridge stated that this movement to the accrual basis results in an approximate \$1.7 million revenue requirement increase in 2013.⁸ Enbridge currently has an application before the Board, EB-2011-0277, to establish the 2012 Transition Impact of Accounting Changes Deferral Account (the "2012 TIACDA"). The total impact to be accommodated by the 2012 TIACDA is approximately \$90 million.⁹ The 2012 TIACDA would be used primarily to capture the retained earnings adjustment relating to the write-off of the OPEB regulatory offset account.

Enbridge stated that

Under USGAAP, such differences are not allowed to be recorded as an asset for financial statement purposes unless there is a regulator order approving future recovery.¹⁰

Board staff notes from Union Decision EB-2011-0025 that the Board stated,

Moreover, approving the establishment of the USGAAP Transition Deferral Account does not guarantee that the amount in the deferral account will be disposed of, consistent with the principles underlying all Board-approved deferral accounts.¹¹

Board staff submits that if the Board approves the establishment of the deferral account 2012 TIACDA, this would not provide any assurance that approval to dispose of the balances recorded in the account will ultimately be given.

Enbridge is proposing to establish a new TIACDA, the 2013 Transition Impact of Accounting Changes Deferral Account (the "2013 TIACDA") in this application.¹² Enbridge stated that as it is seeking recovery of the balance to be recorded in the 2012 TIACDA over a future fifteen year period commencing in 2013, a 2013 TIACDA and further future year TIACDAs will be required to record any approved for recovery of yet un-cleared amounts going forward.¹³ Further, Enbridge stated that no additional principal amounts will be recorded in the TIACDA from January 1, 2013 forward.¹⁴

⁸ Enbridge Response to Board Staff Interrogatory #5d) i) Exh1/Sch1.5/p5

⁹ Enbridge Response to Board Staff Interrogatory #4b) i) Exh1/Sch1.4/p2

¹⁰ Enbridge Response to Board Staff Interrogatory #6) Exh1/Sch1.6/p1

¹¹ Union Gas Decision EB-2011-0025, p19 and p20

¹² Enbridge ExhD1/Tab8/Sch1/p17

¹³ Enbridge Response to Board Staff Interrogatory #4b) v) Exh1/Sch1.4/p2

¹⁴ Enbridge Response to Board Staff Interrogatory #4a) Exh1/Sch1.4/p2

Enbridge also highlighted in its application another difference between CGAAP and USGAAP – Regulatory Deferrals.¹⁵ Enbridge stated that the regulatory deferrals represent the amortization of regulatory assets and liabilities under USGAAP. The amortization represents amounts refunded/collected in rates during the year; and this amortization is presented under USGAAP through a gross up of revenues and expenses, with no net earnings impact.¹⁶ Enbridge declared that the 2013 regulatory deferrals will be accounts and amounts approved by the Board which have no direct impact within the 2013 revenue requirement.¹⁷ However, Board staff is concerned with the \$201 million amount that appears under the column entitled “Regulatory Deferral” at Exhibit A1 / Tab 6 / Schedule 2 Appendix 3 page 2 on the line entitled “Gas commodity and distribution revenue” and how it may impact any amounts collected from or returned to ratepayers.

Enbridge also pointed to the fact that Union Gas Limited is also converting to USGAAP which will mean that the two large gas distribution utilities in Ontario would be reporting using the same accounting methodology. Enbridge noted that other examples of Canadian utilities using USGAAP include: Emera, Fortis BC, AltaGas, TransCanada Pipelines, Hydro One and Ontario Power Generation. Board staff supports Enbridge’s position that consistent adoption of USGAAP would therefore facilitate benchmarking with peer companies. Board staff submits that this will benefit Enbridge and its stakeholders.

Disadvantages to the Utility and its Ratepayers:

Adoption of USGAAP may introduce an additional accounting framework from the Board’s point of view for rate-making. Many utilities in Ontario will likely not have the option of converting to USGAAP, due to such factors as not being listed on a Canadian securities exchange and not being able to seek the option to report under USGAAP from such an exchange. As a result, there may be an inconsistent application of accounting principles between Enbridge and those entities. However, as noted above, the two large Ontario gas utilities, Union Gas Limited and Enbridge, have both proposed to move to USGAAP for regulatory purposes.

¹⁵ Enbridge ExhA1/Tab6/Sch2/Appendix3

¹⁶ Enbridge Response to Board Staff Interrogatory #5f) i) Exh1/Sch1.5/p6

¹⁷ Enbridge Response to Board Staff Interrogatory #5f) iii) Exh1/Sch1.5/p6

Enbridge stated that the push down accounting adjustment revalues Enbridge's assets to the fair market value of those assets at the date on which Enbridge was acquired by its parent. This adjustment was previously recorded in the financial records of Enbridge's parent. Enbridge further noted that the regulated utility line of business financial records do not contain the impacts of any of the push down accounting recognition and therefore none of utility rate base, equity, income or earnings sharing amounts are affected by the push down accounting amounts.¹⁸

Successive Transitions of Accounting Standard and Related costs

On page 19 of the Addendum Report, the Board addresses the issue of the use of USGAAP as a short-term solution, stating:

The Board cautions utilities that the adoption of USGAAP as a short term solution may be counter-productive. If a utility is required to transition to IFRS for financial reporting purposes a few years after adopting USGAAP, certain transitional issues may not have been avoided, but delayed, and additional costs may be incurred if the utility changes its accounting standard twice. The Board will carefully scrutinize the costs incurred to accomplish two successive transitions if the utility seeks to recover these costs from ratepayers.¹⁹

In regards to the issue of successive transitions of accounting standards, Enbridge's evidence stated:

As previously indicated, Enbridge has been granted OSC relief for the 2012 to 2014 fiscal periods. While the Company is confident that it will continue to utilize USGAAP after 2014, there is no resolution that has been decided upon. Enbridge views the limited period exemption provided by the OSC being reflective of the uncertainty with regards to the treatment of rate-regulated operations under IFRS, recognizing that the USGAAP guidance on this front is better reflective of the economic outcomes of the business. Enbridge expects to pursue a further exemption from the OSC at the end of the exemption period, unless IFRS guidance on this front, by that time, becomes largely aligned with that of USGAAP. As an alternative, Enbridge also will have the ability to register with the SEC in the US, so as to secure continued use of USGAAP for financial reporting purposes.²⁰

Enbridge has not, nor is it planning to seek recovery of any incremental USGAAP transition costs in this application. Enbridge has received Board approval to recover a

¹⁸ Enbridge Response to Board Staff Interrogatory #5c) ii) and viii) Exh1/Sch1.5/p3-4

¹⁹ *Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment*, p.19.

total of \$4,171.6 thousand in incremental one-time IFRS transition costs, of which \$2,091.0 was recorded and approved for recovery in the 2009 IFRSTCDA, and \$2,080.6 was recorded and approved for recovery in the 2010 IFRSTCDA.²¹ The amounts were recovered in one-time bill adjustments that occurred in January and October 2011, after a Board review. No IFRS transition costs have been incorporated into ongoing rates.

Board staff notes that Enbridge's future transition plans depend on the status of the convergence of USGAAP to IFRS. As a result of the uncertainty over future standards, Board staff submits that the Board may not be able to assess the full impact of a later transition or convergence by Enbridge at this time. Board staff notes that the Board will have the opportunity to scrutinize the costs of the convergence if Enbridge seeks recovery of the costs in a future Board proceeding.

Benchmarking

Board staff notes that in the Hydro One Networks Transmission ("Hydro One Transmission") proceeding (EB-2011-0268)²² and Hydro One Networks Distribution ("Hydro One Distribution") proceeding (EB-2011-0399)²³, the Board expressed concern about the increased difficulty in benchmarking with other Ontario utilities if Hydro One Transmission and Hydro One Distribution transitioned to USGAAP. Board staff notes that Union Gas Limited has been approved by the Board (EB-2011-0210) to set rates based on USGAAP. Board staff notes that Enbridge acknowledges that Union Gas Limited is also converting to USGAAP which will mean that the two significant gas distribution utilities in Ontario are reporting in a consistent accounting methodology.²⁴ In light of this, Board staff has no concerns related to benchmarking.

Conclusion

Board staff submits that it is appropriate to establish USGAAP as Enbridge's approved accounting standard for rate setting, regulatory accounting and regulatory reporting purposes commencing January 1, 2013.

²⁰ Enbridge ExhA1/T6/S2/p8

²¹ Enbridge Response to Board Staff Interrogatory #7a) ExhI/Sch1.7/p2

²² Hydro One Networks Transmission, Decision with Reasons, EB-2011-0268, p. 13-14

²³ Hydro One Networks Distribution, Decision and Order, EB-2011-0399, p. 9

²⁴ Enbridge ExhA1/T6/S2/p6

Board staff submits that Enbridge has satisfied the requirements outlined in the Addendum Report:

- Enbridge has demonstrated that it is eligible under the relevant securities legislation to report financial information using USGAAP;
- Enbridge has included a copy of the authorization to use USGAAP from the relevant securities regulator;
- Enbridge has listed the benefits and disadvantages of using USGAAP as opposed to MIFRS for rate regulation; and
- Enbridge has addressed the Board's concerns regarding the costs that could be incurred by two successive transitions or a convergence of USGAAP to IFRS over time. The Board may need to address this issue in a future rate case, if and when a request for funding is filed with the Board.

All of which is respectfully submitted.