EB-2011-0354

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, 2013.

INTERROGATORIES OF CANADIAN MANUFACTURERS AND EXPORTERS (CME), CONSUMERS COUNCIL OF CANADA (CCC), SCHOOLS ENERGY COALITION (SEC) AND THE VULNERABLE ENERGY CONSUMERS COALITION (VECC) hereinafter "CME et al."

E. Cost of Capital

Issue 1

Is the forecast of the cost of debt for the Test Year, including the mix of short and long term debt and preference shares, and the rates and calculation methodologies for each, appropriate?

Reference: EGDI Evidence E1, Tab 1, Schedule 1, Tables 1 to 4, Testimony of K. Culbert.

Interrogatory 1

Cost of $100M preference shares

a) Please provide the history of EGDI's preference shares and in particular why the cost has decreased from 5.0% in 2007 to 2.48% in 2011 and is forecast to increase to 4.16% in 2013, when there is no new preferred share financing planned.

b) Please indicate the breakdown of the preferred shares into floating and fixed rate preferred shares.

c) Please provide a before tax cost analysis of EGDI's use of preferred share financing versus the use of straight debt.

d) Please indicate the breakdown of the preferred share financing in terms of their balance sheet allocation, that is, are they treated as debt, equity or preferred shares.

e) Please indicate whether EGDI or Concentric has taken these preferred shares into account in their capital structure recommendation and if so how.

Interrogatory 2

Reference: EGDI Evidence E1, Tab 2, Schedule 1,Testimony of D. Yaworski.

Commercial paper and long term debt cost

a) Please provide an all-in cost analysis of the commercial paper program by including forecast “interest” costs as well as standby and other bank fees.

b) Please indicate whether the typical electricity distributor allowed a 40% common equity ratio by the Board has access to the CP market, and if not please explain why not.

c) Please confirm that EGDI maintains the ability to issue first mortgage bonds, as confirmed in previous hearings, and that these bonds are not covered by a 2X interest coverage ratio new issue restriction.

d) For each of the years 2007 to 2011 inclusive, please provide EGDI’s actual earnings and its interest coverage ratio.

e) Please provide EGDI’s interest coverage ratio for 2013 using a 36% equity ratio and the Board’s Formula ROE.

f) Please list all of EGDI’s financings since January 1, 2007 and provide the amount of time that elapsed between the date information circulars were distributed to the public soliciting support for the investments and the date and time when the investments described therein were fully subscribed.

g) How do the rates that EGDI paid for each of its financings in the period 2007 to date inclusive compare with the cost of debt derived using the formula the Board approved in its December 11, 2009 Cost of Capital Report?

Issue 2

Is the proposed change in capital structure increasing Enbridge's deemed common equity component from 36% to 42% appropriate?

Interrogatory 1

Reference: EGDI Evidence E2, Tab 1, Schedule 1 Updated, Testimony of R Fischer et al

Return on Equity, pages 1 to 3

a) Please provide a table showing EGDI’s allowed ROE, actual ROE on a weather adjusted basis, actual unadjusted ROE, and actual unadjusted ROE before sharing since 1990, that is, prior to the 1993 and 2006 business risk assessments.

b) Please provide for each year since 1997 and the use of a formula ROE, the ROE broken out into the risk free rate component and the earned risk premium component (residual).

c) For each year since 1997 please provide a table with the average amount of common equity used for rate making purposes, and the amount of net income with the net income broken out into the risk free rate and risk premium component as identified in b) above.

Interrogatory 2

Reference: EGDI Evidence E2, Tab 1, Schedule 2, Testimony of R. Fischer et al

Capital Structure: Equity Ratio at pages 1 and 2

a) What is the purpose of graphing the common equity ratio against the allowed ROE over different points in time?

b) Please provide an equivalent graph to that on page 1 except graphing the allowed risk premium against the common equity ratio.

c) Does EGDI consider US utilities to be peers of EGDI in the sense that comparisons can be made without any adjustments?

d) Does EGDI accept that there are capital market differences between the US and Canada as reflected in Concentric's 0.74% adjustment for different long term (30 year) government bond rates?

e) Please confirm that DBRS has an A stable rating for EGDI and indicate when DBRS last rated EGDI as BBB+ or lower.

f) Please confirm that:

   (i) EGDI's S&P rating is a flow through of its parent Enbridge Inc.,

   (ii) The concern expressed by S&P is that EI's business risk has increased due to the competitive toll settlement (CTS) on the Enbridge System, and not that there has been a change in EGDI's risk.

g) Please confirm that if EGDI's debt cost increases due to an S&P downgrade flowing from the CTS on the Enbridge System that EGDI will *not* ask for those higher debt costs to be passed on to EGDI's Ontario ratepayers.

Interrogatory 3

Reference: EGDI Evidence E2, Tab 1, Schedule 2, Testimony of R. Fischer et al

Business risk at pages 2 to 8

a) Will any of the EGDI's witnesses, R. Fischer, M. Lister and D. Yaworski be presented as expert witnesses with respect to business risk analysis?

b) Please provide copies of any rating or analyst reports that reflect the company's view on page 3 that the volumetric demand profile, system size and complexity, and environmental and technological advancements indicate an increase in the company's business risks since July 2007 when the Board determined EGDI's equity ratio to be 36%.

c) Please indicate whether the use of high efficiency gas furnaces and the resulting persistent reduction in the demand for gas has increased the forecasting error attached to EGDI's revenue requirement, and if so quantify its impact on ROE variability.

d) Please provide regulatory precedent for the proposition that increased size is a risk factor as claimed by EGDI.

e) Please advise whether EGDI is aware of prior Ontario Energy Board Decisions accepting that increased size is a risk *mitigating* factor.

f) Please provide a copy of the business risk testimony filed in support of EGDI's request for 38% common equity in 2006 and a brief synopsis of the major risk factors identified at that time and whether or not those risk factors remain relevant or have changed in a material way.

g) Please restate the 1993 capital expenditures of $247.5 million in 2012 dollars, that is, please adjust for the inflation between the two time periods (page 6).

h) Please provide a table showing the free cash flow, that is, cash flow from operations and capital expenditures (separately) for each year since 2000.

i) Please indicate the difference in financing problems faced by free cash flow positive and free cash flow negative firms.

j) In previous business risk testimony, experts have provided cost comparisons of natural gas with alternative fuels. For 2006 (as filed at that time), as well as currently, please provide a cost comparison for industrial users, commercial users and residential users in the major rate classes on a consistent basis for all three users of natural gas against the major competitive fuels such as fuel oil and electricity.

k) Further to (i) above, please reproduce extracts from company securities filings (prospectuses etc.) for 2006, as well as currently, that discuss inter-fuel competition.

l) In previous business risk evidence, experts have always rated gas distributors partly on the basis of the composition of their demand. Please confirm that the company judges such comparison to still be useful and provide for 2006 and currently a revenue breakdown (minus gas costs) for industrial, commercial and residential users for EGDI, Union Gas, ATCO Gas, GMI and Fortis Energy BC (and predecessor companies such as BC Gas, TGI, Inland Gas etc.).

Interrogatory 4

Reference: EGDI Evidence E2, Tab 1, Schedule 2, Testimony of R. Fischer et al

EGDI Peers at pages 8 to 12

a) Please provide a table containing all S&P's current bond ratings for US regulated gas and electric utilities along with their business risk designation.

b) Please confirm that the median bond rating for US gas and electric utilities rated "excellent" in terms of their business risk profile is BBB, while that in Canada is A.

Interrogatory 5

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

a) Please provide the CVs of the authors of the Concentric report.

Interrogatory 6

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

On page 3, Concentric indicates that EGDI's current common equity ratio does not satisfy the financial metrics for an A- or above rating and is not sufficient to ensure that EGDI will continue to meet its forecast coverage ratios and debt covenants.

a) Does any rating agency place 100% reliance on "financial metrics"?

b) Is EGDI currently rated A (Stable) by DBRS?

c) When, if ever, was EGDI rated *below* A by DBRS?

d) Please provide a table with the financial metrics for EGDI from 2006 to the present with the DBRS bond rating for each year.

e) Is there any legal requirement for EGDI to finance with MTNs, where the 2.0X interest coverage covenant restriction exists?

f) Does the 2.0X interest coverage covenant restriction prevent EGDI from issuing first mortgage bonds, preferred shares, or Commercial Paper ("CP") swapped into longer term fixed rate debt?

Interrogatory 7

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

On page 7, Concentric discusses its procedure for generating proxy groups.

a) Please indicate why Concentric considers it important to have energy holding companies in the proxy group.

b) Please explain why Canadian Utilities, Emera, Fortis, Valener and Veresen are not used as Canadian comparables.

c) Please comment on any differences in risk between holding companies and operating companies.

Interrogatory 8

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

On page 9, Concentric discusses its ROE analysis.

a) On page 10, Concentric indicates that in 2009 its recommended ROE was 10.50% but a similar analysis today indicates 10.83%. Please indicate the current and forecast level of the long Canada bond yield at the time of the 2009 analysis and that for the current report.

b) Please compare the level of stress in the Canadian financial system today with 2009.

c) Please provide a table with the <u>actual</u> and <u>allowed</u> ROE for each of the 7 US comparables, and for EGDI, for each year since 2006.

d) Please confirm that capital market conditions in the US and Canada are different as indicated by the 0.74% difference in government bond yields (footnote 12).

Interrogatory 9

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

On page 13, Concentric discusses the Board's capital structure methodology for gas distribution utilities and notes the EGDI request for 38% common equity in 2006, and the Board's determination of an equity ratio of 36% for EGDI, being a ratio that Union Gas Limited ("Union") had already accepted as reasonable.

a) Please produce a copy of the evidence of Dr. Carpenter and provide a list of the risk factors that EGDI put forward at that time and advise whether any of them have increased or decreased since that date.

Interrogatory 10

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

On pages 17 to 22, Concentric discusses EGDI's business risk environment structure and fair return standard.

a) With respect to Figure 2 at page 19, please indicate whether EGDI's operating cash flow minus capital expenditures ("free cash flow") is positive or negative for the period 2012-2016 and whether EGDI would be regarded as a growth firm.

b) What is the purpose of graphing ROE against normalized average use as shown in Figure 3 on page 20.

c) Please produce a copy of the Graham and Harvey article referenced at page 20 and in footnote 23.

Interrogatory 11

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

At pages 22 to 27, Concentric discusses credit ratings and provides its hypothetical credit ratings for EGDI. At pages 28 to 30, Concentric compares equity ratios among North American gas distribution utilities.

a) Please identify any Canadian regulator that has "set a goal of the lowest possible investment grade credit rating" in the context of the discussion on page 22.

b) Please provide any precedent decisions where a regulator relied on hypothetical rather than actual credit ratings in determining utility equity ratios.

c) Please provide the full data used to generate the graph on page 27 in machine readable Excel format so that the graph can be replicated.

d) Given the lower common equity ratios of the Canadian utilities shown in Figure 7 on page 31, compared to the US utilities, please explain why all of the Canadian utilities have good investment grade bond ratings.

e) Please confirm that the costs of debt recoverable from EGDI ratepayers should be unaffected by any future S&P downgrades attributable to problems at EGDI's holding company.

Interrogatory 12

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

Appendix B discusses regulatory treatment but makes no reference to analyses done by S&P and Moody's of differences between regulatory treatment of utilities in the US and Canada..

a) Is Concentric aware of these analyses of differences?

b) If so, does Concentric agree with these analyses of those differences?

Issue 3.

Is the proposal to use the Board's formula to calculate return on equity appropriate?

Interrogatory 1

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

Appendix A discusses ROE analysis: DCF Model

a) Please explain why Concentric does not use a two stage growth model.

b) Please provide Concentric's estimate of the long run nominal GDP growth rate in the US.

c) Please indicate how differences in analyst earnings growth rates which differ dramatically across different service providers can be reconciled. For example, for Southwest Gas the forecast growth rate varies from 9.0% for Value Line to 2.2% for Thomson First Call.

d) Are growth rates subject to an "optimism bias". If so, how has Concentric adjusted for this?

e) Please indicate how many analysts are involved in the forecasts in Exhibit 05, pages 1 and 2.

f) Please indicate whether Concentric has used a "quarterly compounding" growth rate estimate for the forecast dividend yield and whether dividends are actually increased on a quarterly basis.

g) Please provide the quarterly dividend per share history for each US and Canadian firm in Concentric's analysis since 1990 to verify whether the dividends are increased annually or quarterly.

Interrogatory 2

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

Appendix A discusses ROE analysis: CAPM Model.

a) Please explain why Concentric uses a "long term forecast of the 10 year government bond yield" rather than the appropriate rate for the test year.

b) Please confirm that both Bloomberg and Value line routinely adjust actual betas by the Blume methodology that assumes that actual beta estimates have measurement error and thus average them with 1.0 the mean beta for the market as a whole.

c) Please indicate any Canadian regulator that has explicitly accepted the Blume beta adjustment methodology.

d) Please provide any research on the correct adjustment procedures for utility betas.

e) Please provide a copy of the reports referenced in footnote 43 (mainly the data tables) to replicate the claimed market risk premiums cited on page A-4.

f) Please confirm that the cited market risk premiums are for the relevant equity return over the return on long government bonds.

g) In terms of the "corroborating" evidence in Concentric 09 please conform that Concentric assumes that these growth rates (up to 667%) are valid inputs into the DCF model and fairly estimate the investor's fair rate of return.

Interrogatory 3

Reference: EGDI Evidence E2, Tab 2, Schedule 1, report of Concentric Energy Advisors.

Appendix A discusses ROE analysis: Leverage adjustments.

a) Please confirm that the Hamada adjustment underlying the graph on page A-6 flows from a classical tax system where the shareholders capture the tax advantage from debt financing, that is, the value of the levered firm is equal to that of an unlevered firm plus the M&M 1963 tax shield value from debt.

b) Please comment on the relevance of the adjustment in the context of the Canadian tax system.

c) Please comment on the validity of the equation on page A-7 for Canadian regulated utilities.

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