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BY EMAIL and RESS

November 9, 2012
Our File No. 20110354

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2011-0354 – Enbridge 2013 Rates – Equity Thickness

We are counsel for the School Energy Coalition. Pursuant to Procedural Orders #5 and #6 in this proceeding, these are SEC's submissions with respect to the Board's process for dealing with Cost of Capital Issue E2 – Equity Thickness.

These submissions deal with the procedure for this issue in two steps.

First, we look at the scope of the issue itself, and the difficulty we have had in determining the position Enbridge is taking on this in the context of a) the Board's stated policies on cost of capital, and b) the terms of the Settlement Agreement. This is about identifying what actually remains in dispute in this proceeding. This will clearly drive the determination of the appropriate procedure to be followed.

Our conclusion with respect to the first step is that the Board should issue a decision clarifying the scope of the remaining issue, and that may involve clarification from the Applicant of its position, and then submissions from the other parties, including SEC.

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Second, we consider how, once the actual issue in dispute is clearly identified, the evidence of the experts should be received by the Board, and then tested by the Board and the parties pursuant to the Board's rules and the general legal rules relating to evidence before the Board.

In general, we are relying on other parties to provide the Board with a detailed discussion of the legal rules associated with this type of expert evidence. Our submissions are limited to preserving SEC's rights of procedural fairness in the process.

Scope of Issue

There was a time when Board panels heard full evidence on the cost of capital and capital structures of gas utilities in every rate case. Experts were brought in to express opinions on risk, methodology, comparables, and results. The Board then made an overall determination on each of the relevant components of the issue.

Two things have happened to change that.

1. The Board issued its report in EB-2009-0084, ***Report of the Board on the Cost of Capital for Ontario's Regulated Utilities,*** December 11, 2009 (the "Policy"), which sets out in considerable detail how the Board will establish the cost of capital for regulated utilities, including ROE, cost of debt, and debt/equity ratio.

   While the Policy is, of course, a policy document, and therefore not binding on individual Board panels, the Board only a few days later provided clear guidance how it should be applied in individual cases. In EB-2009-0096, a proceeding with respect to Hydro One's distribution rates, SEC and others argued that in any given case, the Board panel had to decide the appropriate cost of capital for the Applicant based on the evidence in that proceeding, consistent with the Fair Return Standard. The Board responded with an oral decision on December 15, 2009 (the "Application Decision"), as follows [Tr.6:147]:

> "*The Board has considered the submissions of Mr. Warren on behalf of CCC, CME and VECC, and has also reviewed and considered the letter filed by Mr. Shepherd this morning on behalf of Schools which requests that the Board determine the components of the cost of capital for Hydro One based on the evidence in this proceeding….*
>
> *The Board does not intend to reopen the cost of capital policy, which was only recently determined after a lengthy and thorough review by the Board. The Board was assisted in this review by a wide variety of interested parties and experts, many of whom are intervenors in this proceeding. The Board considers the cost of capital policy to be sufficiently robust to apply across the board to all electricity LDCs. The prior policy also applied to all LDCs.*
>
> ***The Board does, however, recognize that it is open to parties to argue that there may be certain circumstances where the policy should not be applied. The Board will, therefore, allow the filing of evidence that***

> ***establishes the specific circumstances, which exist in this case and with this applicant, which would make the application of the policy inappropriate****." [emphasis added]*

We note that the Policy applies equally to gas LDCs. The effect of the Application Decision is that the Policy is not binding, but operates as a kind of default, like a rebuttable presumption. It is open to parties to file evidence to show that it should not be applicable in a given case, but absent such evidence it will apply. To the best of our knowledge, the Application Decision has been followed consistently since that time.

2. The Parties in this proceeding entered into a Settlement Agreement, in which among other things all Parties agreed to settle Issue E3, which establishes the return on equity to apply to the Applicant for the Test year. The Board's formula, as approved in the Policy, is the agreed calculation of the ROE.

The effect of the first of these changes would appear to be that, if the Applicant in this case is proposing an ROE or an equity thickness that is different from one consistent with the Policy, the Applicant has the onus of leading evidence to show that the Policy should not be applied in this case.

The effect of the second of these changes is more complex. It appears to be common ground, and certainly accepted practice at the Board, that the equity thickness and the ROE are linked. The equity thickness is determined based on risk, and is largely driven by how much equity is needed to optimize the cost of debt. The equity layer provides a safety cushion reducing the risk of the debt, and so its thickness is a debt-oriented decision driven by risk analysis. This is consistent with the Policy as well, which says that equity thickness is changed only when business risk has changed. Once the equity thickness is determined, an appropriate ROE is determined, based on appropriate comparables and the application of the Fair Return Standard. It also appears to be accepted that the Fair Return Standard is met with a lower ROE for thicker equity, and higher ROE for thinner equity.

SEC believes the impact of these two changes to be that the scope of Issue E2 is precise and tightly defined. It is not a discussion of cost of capital. It is a discussion of equity thickness only, meaning essentially risk analysis, in the context of a Policy that, unless supplanted by evidence, will be applied by this Board panel.

Enbridge Position

Against this backdrop, SEC has watched with interest the development of the Joint Experts' Report. While we were not directly involved (it was being handled by others), we could see that the obvious limitations on the scope of Issue E2 do not appear to be reflected in the Joint Experts' Report. In particular, the experts for the Applicant, in advocating for their client, appear to be taking a much broader view of what remains in issue in this proceeding. It is not clear to us whether, in doing so, they are authorized to speak on behalf of Enbridge, their client, or not.

The result of this is that SEC does not know what position the Applicant is taking with respect to equity thickness. Based on the evidence, and the Joint Experts' Report, it could be any of the following:

1. ***The Policy is irrelevant. The Fair Return Standard is a legal requirement, and each Board panel is obligated to consider it anew regardless of what the Policy says.*** We have obvious sympathy with this argument (as we made it in a losing submission in EB-2009-0096), but it has two problems: the resulting Application Decision, which rejected that argument, and the fact that the crux of the Fair Return Standard, ROE, has already been settled. If the Applicant's argument is in fact the Fair Return Standard, then one result may be that implicitly the Applicant is resiling from its agreement with respect to ROE. That would bring other – very difficult – issues into play.

2. ***The Policy should not be applied in this case. In lieu of applying the Policy, the Fair Return Standard should be analysed in full.*** This has the problem that there would appear to be no evidence that the Applicant is in a different position from other utilities to which the Policy applies. This could be particularly problematic given the recent Board decision on this same issue in EB-2011-0210 with respect to Union Gas. In addition, here also the Applicant comes up against the problem of the settled ROE, and the implicit challenge to that settled rate if the Fair Return Standard remains fully in issue.

3. ***The Policy does not apply to equity thickness, but only to ROE.*** The problem with this is the specific references to equity thickness and risk in the Policy. It also leaves unanswered the question of how the equity thickness can be changed when the ROE has already been set.

4. ***The Policy applies. However, it should be taken to refer back to the establishment of the Applicant's ROE and equity thickness in 2006, so the Board should test changes in risk since then.*** This also has three problems. First, it would imply that the Policy did not meet the Fair Return Standard for the Applicant in 2009. While we know that is Concentric's view, that does not appear to be the Board's conclusion in the Policy. It could only be true if the Policy is wrong. Second, there does not in any case appear to be any credible evidence that the risk level of the Applicant has changed materially since 2006. Third, increasing risk at a 36% equity thickness should on those assumptions have warranted an increased ROE, but the Applicant only asked for, and settled on, the Board's formula ROE.

5. ***The Policy applies. The Applicant's risk has changed materially since 2009.*** This is the simplest position, and the Board can assess whether the evidence supports a change in risk (i.e. an increase) since 2009.

We have probably not included all possible Enbridge positions, but these are the ones that appear possible on the face of the evidence.

It is our submission that the Board and the parties are entitled to know what position the Applicant is putting forward. This is required legally, of course, but also required for practical purposes.

If it is #5 above, as we would expect, especially given the EB-2011-0210 decision, then the Board's consideration of the expert evidence in this case is much simplified. However, the Joint Expert's Report would then appear to require some amendment, since it obviously goes far beyond Issue E2 as #5 above describes it.

Conversely, if it is #1 above, finalization and receipt by the Board of the Joint Experts' Report is premature. The experts are not put forth, as we understand it, as having expertise in the primary issue raised by #1, which is an issue of legal interpretation. Just as the Board did in the Application Decision, if this legal interpretation is the Applicant's position then the Board should entertain submissions on the application of the Policy, and render a decision on how the Policy and the Fair Return Standard interact.

As is obvious, the Board's response to #2, #3 and #4 would be equally particular, although we note that in each of those cases, as with case #1, the expertise of the experts is not engaged until a preliminary question of interpretation is determined. The input of the experts is neither required nor appropriate to those interpretation issues.

All of this leads us to the conclusion that, before the Board can establish the procedure for dealing with the cost of capital issue, the Board and the parties need to know the Applicant's position so that the Board can determine the scope of the dispute remaining.

Procedure

Given the above analysis, SEC proposes the following procedure to deal with Issue E2:

a. Enbridge should be required to deliver to the Board and the parties a clear and accurate statement of the position they are taking with respect to equity thickness, including whether they say the Policy is applicable, and how, and how they say the equity thickness issue interacts with the settlement of ROE issue E3.

b. Based on the scope of the issue as Enbridge thus proposes it, (and unless Enbridge's position is #5 above), all parties should have an opportunity to make submissions to the Board on whether that scope is appropriate, too broad, or too narrow.

c. The Board should make a determination on the scope of the issue on which the Board's determination is required.

d. The Joint Experts' Report should be reviewed, first by the experts, to determine whether it should be amended in light of the Board's ruling on scope.

e. The Board should review the (potentially, amended) Joint Experts' Report to ensure that it is within scope.

In our submission, it is only once these steps have been completed that the question of how to best receive and test the expert evidence arises.

With respect to that procedure, the one additional comment SEC wishes to make is with respect to cross-examination. We understand that the Applicant may be proposing that only one counsel for the parties that sponsored Dr. Booth should be allowed to cross-examine Mr. Coyne and Ms. Lieberman.

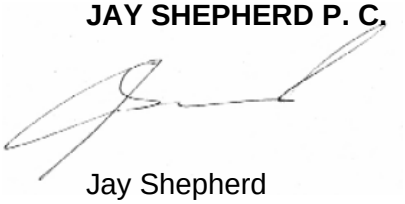
If that is indeed the proposal, SEC strongly objects. At no time was any notice or suggestion given to SEC that co-sponsoring an expert would result in the loss of a fundamental procedural protection for SEC, the right to test evidence through cross-examination under oath. Had SEC believed that this was a price to be paid for being a co-sponsor, SEC would not have agreed to do so. In the event that the Board determines that only one co-sponsor can cross-examine, then SEC will immediately withdraw as a co-sponsor to preserve its rights. This is not because we have any problem with Dr. Booth's evidence, but because we value our legal right to test the evidence of the utility.

Conclusion

It is submitted that the scope of Issue E2 is currently unclear because the Board and the parties do not know the case on cost of capital and/or equity thickness that the Applicant is purporting to advance. Once the Applicant's argument is clear, the Board can make a determination as to scope. Once the scope is clear, a procedure for hearing the evidence – whether simplified, or very complex – must in our submission maintain the rights of the parties to challenge opposing experts by way of cross-examination.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.



Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested Parties