500 Consumers Road
North York, Ontario M2J 1P8
PO Box 650
Scarborough ON M1K 5E3

Lorraine Chiasson
Regulatory Coordinator
phone: (416) 495-5962
fax: (416) 495-6072
Email: lorraine.chiasson@enbridge.com

November 30, 2012

VIA HAND DELIVERED

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")
2013 Rate Adjustment Application
Ontario Energy Board ("Board") File Number EB-2011-0354

Pursuant to the dates set out in the Board's email note dated November 16, 2012, enclosed please find Enbridge Gas Distribution's Argument-in-Chief.

The above document has been filed through the Board's RESS and will be available on our website at www.enbridge.com/ratecase.

Sincerely,

[original signed by]

Lorraine Chiasson

encl.

cc: Mr. F. Cass, Aird & Berlis LLP
All Interested Parties EB-2011-0354

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.

ENBRIDGE GAS DISTRIBUTION INC.
ARGUMENT IN CHIEF

A. INTRODUCTION

1. This is the argument in chief of Enbridge Gas Distribution Inc. (Enbridge) submitted in accordance with the schedule for written submissions established during the oral hearing of evidence in this proceeding.[1]

2. In its Decision and Procedural Order No. 6 issued on November 2, 2012, the Board accepted the revised Settlement Agreement that was filed in accordance with the directions of the Board. The Settlement Agreement identifies one issue (Issue E2) for hearing, as follows: "Is the proposed change in capital structure increasing Enbridge's deemed common equity component from 36% to 42% appropriate?". The Settlement Agreement also indicates (under Issue E1) that there is no agreement on the forecast cost of debt and mix of short and long term debt and preference shares in the event that Enbridge's equity ratio is increased from 36%.

3. In support of its request for an increase in equity ratio from 36% to 42%, Enbridge filed its own evidence[2], as well as expert evidence from Concentric Energy Advisors, Inc. (Concentric)[3]. Four intervenors, the Vulnerable Energy Consumers Coalition (VECC), Canadian Manufacturers & Exporters (CME), the Consumers Council of Canada (CCC) and

[1] See 2Tr.234.
[2] Exhibit E2-1-2.
[3] Exhibit E2-2-1.

the School Energy Coalition (SEC), sponsored and filed expert evidence from Dr. Lawrence Booth in response.[4] These four intervenors were referred to in Procedural Order No. 5 as the “Consortium”.

4. The Board prescribed a process for hearing the outstanding issues, including the presentation of the expert evidence through a concurrent expert witness panel. As a first step, the process included an experts’ conference, following which a “Joint Written Statement” was prepared and filed by Concentric and Dr. Booth[5]. At the oral hearing, the Board first heard from the witnesses responsible for Enbridge’s own evidence. Next, the expert witnesses appeared as a joint panel and a process was followed that allowed for, among other things, the expert witnesses to question one another and the same questions to be put to each expert witness immediately in succession.

5. In this Argument in Chief, Enbridge sets out how the evidence in this case, including the evidence from the concurrent expert witness panel, supports a determination that the Company’s current equity ratio of 36% does not meet the Fair Return Standard, and an increase in equity thickness to 42% is warranted.

B. OVERVIEW

6. The Board’s 2009 Cost of Capital Report confirmed that the governing standard, and indeed the legal requirement, for cost of capital determinations, is the Fair Return Standard. The Report also indicated that equity thickness will be reassessed by the Board in the event of changes in business or financial fundamentals or risks. In this case, Enbridge has presented evidence regarding the changes that have occurred with respect to its business risks and Dr. Booth, the expert witness who testified on behalf of the Consortium, has unequivocally confirmed that conditions are appropriate for the Board to reassess Enbridge’s equity thickness in this case.

[4] Exhibit L, Tab 21.
[5] Exhibit L, Tab 22.

7. All experts on the equity thickness issue have agreed that the Fair Return Standard applies to the Board's assessment of equity thickness for Enbridge. Given the acceptance by the Consortium's expert that this is an appropriate case for reassessment of Enbridge's equity thickness, the issue between the parties then becomes one of the proper application of the Fair Return Standard. Concentric has conducted a full and comprehensive review of the application of the Fair Return Standard to Enbridge's cost of capital, including equity thickness, resulting in the conclusion that an appropriate level of equity for Enbridge is 40 per cent to 45 per cent at the level of Return on Equity (ROE) currently produced by the Board's ROE formula. Enbridge submits, as set out below, that Dr. Booth has not conducted a full and comprehensive review of the application of the Fair Return Standard to the assessment of an appropriate equity ratio for Enbridge.

C. THE BOARD'S COST OF CAPITAL REPORT

8. In 2009, the Board initiated a consultative process to assist it in a review of its cost of capital policies.[6] The outcome of this process was the EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, issued on December 11, 2009 (the Cost of Capital Report).

9. The Cost of Capital Report confirms that the Fair Return Standard is a mandatory legal requirement that must be satisfied in any cost of capital determinations of the Board.[7] The Fair Return Standard is meant to ensure that a utility investor will receive as large a return in its investment as it would receive if investing in securities with attractiveness, stability and certainty that are equal to that of the utility's business.[8] The utility's return should be reasonably sufficient to ensure the financial viability of the utility and should be adequate to maintain its credit and enable it to raise necessary capital.[9]

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[6] EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, at page i.
[7] Cost of Capital Report, at pages i, 15 and 18.
[8] Cost of Capital Report, at page 17, citing *Northwestern Utilities Limited v. City of Edmonton*, [1929] S.C.R. 186.
[9] Cost of Capital Report, at pages 16 to 17, citing *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia et al* 262 U.S. 679 (1923).

10. The Board's Cost of Capital Report confirmed that the Fair Return Standard requires that a fair or reasonable return on capital should: (i) be comparable to the return available from the application of invested capital to other enterprises of like risk (the Comparable Investment Standard); (ii) enable the financial integrity of the regulated enterprise to be maintained (the Financial Integrity Standard); and (iii) permit incremental capital to be attracted to the enterprise on reasonable terms and conditions (the Capital Attraction Standard).[10]

11. As set out in the Cost of Capital Report, all three of the requirements of the Fair Return Standard set out above must be met in any of the Board's determinations of cost of capital, and none ranks in priority to the others. Focus on meeting the Financial Integrity Standard and the Capital Attraction Standard without giving adequate consideration to the Comparable Investment Standard is not sufficient to meet the Fair Return Standard.[11]

12. The Board noted in the Cost of Capital Report that capital structure was not a primary focus of the EB-2009-0084 consultation.[12] The Report does indicate, though, that "capital structure should be reviewed only when there is a significant change in financial, business or corporate fundamentals". In the case of gas distributors, the Report notes the Board's policy that "a full reassessment of a gas utility's capital structure will only be undertaken in the event of significant changes in the company's business and /or financial risks".[13]

D. CHANGES IN ENBRIDGE'S BUSINESS RISKS

13. Changes in Enbridge's business risks were addressed both in Enbridge's own evidence and in the evidence of Concentric. Enbridge's evidence reviewed significant changes in business risk from the perspective of Enbridge;[14] Concentric's evidence reviewed changes in the risk environment for the natural gas distribution business.[15] Together, this evidence demonstrates that there have been significant changes in Enbridge's business and financial risks over the long term (that is, since 1993), and over the period from the last time when Enbridge's equity ratio was adjusted (that is, since 2007).

[10] Cost of Capital Report, at pages 18 and 19.
[11] Cost of Capital Report, at page 19.
[12] Cost of Capital Report, at page 50.
[13] Cost of Capital Report, at pages 49 and 50.
[14] Exhibit E2-1-2, pages 2 to 8.
[15] Exhibit E2-2-1, pages 18 to 22.

14. It is important that changes in Enbridge's business and financial risks be viewed over the long term. Enbridge's equity ratio should be commensurate with its long-term business risks, which can only be assessed through a long-term view.[16] That is why Enbridge has presented business risk evidence showing changes over the past 20 years. While it is true that Enbridge's equity ratio was considered in a 2006 proceeding, the fact is that there is now additional information available that was not considered at that time. This additional information adds to the conclusion that Enbridge's business and financial risks have increased, over both the long term and the more immediate term.[17] To confine the examination of changes in Enbridge's business risks to consider only changes since 2006 would result in an incomplete examination and evaluation. As Enbridge's witness, Mr. Lister, stated:

> … there has been new information developed, or new issues have arisen over the period of time from 2007, which either were not considered in the 2007 case, or new information that might have been considered in the 2007 case that were not. … we believe the Board can only benefit from looking at all of the information available, and it is not necessary and the policy doesn't indicate that it is necessary to pick a precise date for the time period of measurement. … the Board expects that the … common equity ratio will be maintained or stable for a long period of time. So it is only reasonable to conduct an analysis that includes a long-term historical and prospective view.[18]

15. Enbridge's evidence explains the significant changes in business risk that have occurred since 1993 and 2006 by reference to developments in the following areas:

    (1) volumetric demand profile;

    (2) system size and complexity; and

    (3) environmental and technological advancements.[19]

16. With respect to volumetric demand profile, the undisputed evidence in this case is that Enbridge's average residential gas consumption has been in decline for decades. The rate of decline in average use of natural gas by Enbridge's customers has increased in recent years. Over time, declining consumption puts upward pressure on distribution rates, as the

[16] 1Tr.43-44.
[17] 1Tr.46
[18] 1Tr.43-44.
[19] Exhibit E2-1-2, pages 3 to 8.

existing level of costs is apportioned over smaller volumes. Ultimately, such increases in distribution rates can have the effect of reducing the competitiveness of natural gas and increasing the likelihood that customers will look to fuel-switch or reduce consumption further.[20]

17. This decline in average use, which is being experienced even with low gas commodity prices, is a business risk for natural gas distributors. That business risk is explained in the following testimony by the Enbridge witness panel:

> …we have seen a continued decline; not only a continued decline, but a faster decline in average uses even while gas prices have been low, and we expect gas prices to go up.[21]

18. The fact that gas prices have fallen since 2006 is the focus of Dr. Booth's evidence regarding changes in business risk.[22] However, Dr. Booth makes no attempt to address the evidence that, even during a period of relatively low gas prices, the decline in average use of gas by Enbridge's customers has not only continued, but accelerated. Stated differently, although Dr. Booth acknowledges that part of the business risk faced by a distributor relates to whether there is a continuing market demand for the product,[23] his evidence fails to address the impact of the declining market demand for natural gas on an average use basis.

19. For his part, Mr. Coyne noted the acceleration in the decline of average uses over the most recent five years[24] and he also brought out other important considerations in relation to "a downward path for prices". While lower prices are "good news for consumers", Mr. Coyne testified that they create the need for complete reconsideration of the makeup of every gas distributor's supply plan. Moreover, Mr. Coyne pointed out that there is no guarantee of continued lower prices, especially since natural gas is now an increasingly global commodity subject to global supply and demand in relation to competing fuels.[25]

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[20] Exhibit E2-1-2, pages 4 and 5, paras. 10 and 16; see also Exhibit A2-1-1, pages 13 to 15.
[21] 1Tr.111.
[22] Exhibit K2.1, page headed "EGDI's Business risk in 2006" and 2Tr.46-48.
[23] 2Tr.46.
[24] 2Tr.16.
[25] 2Tr.16.

20. In the result, there is a very real business risk faced by Enbridge related to gas consumption by Ontario customers. The level of consumption continues to fall, even in a low price environment. This risk is only increased when one takes into account the likelihood that gas prices will rise again over the coming years.

21. On the subject of system size and complexity, the evidence in this case reveals that a number of factors have come together to cause a significant increase in the complexity of managing Enbridge's gas distribution system. These include the sheer increase in the size of the system; the need to deal with a consumption profile that, despite declining average annual consumption, puts increasing peak day demands on the system; and the application of higher standards for pipeline integrity to this system.[26]

22. A salient feature of this particular case is that Enbridge has, for the first time, completed and filed an Asset Plan with a comprehensive analysis of the condition of its assets. This Asset Plan shows a clear need for higher and growing capital expenditures by Enbridge in future years[27] and it also shows that asset condition is an area of considerable uncertainty.[28] Among the challenges explained in the Asset Plan that Enbridge is facing in relation to its distribution assets are the following: (i) aging assets and the corresponding need to address classes of assets near the end of their useful life (such as copper services, AMP fittings[29] and compression couplings);[30] (ii) the need to conduct studies to better understand the condition of classes of assets where risks have been identified (such as corrosion on mains and services, AMP fittings and winglock valves);[31] and (iii) the need to comply with evolving pipeline safety regulatory requirements that are becoming more prescriptive in the wake of industry events such as the San Bruno incident.[32] Each of these challenges adds to the uncertainty faced by Enbridge in evaluating and predicting future costs related to its most significant, expensive and important asset: the Company's distribution system.

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[26] Exhibit E2-1-2, pages 5 to 7, paras. 17. 19 and 22.
[27] 1Tr. 8.
[28] 1Tr.170-171.
[29] AMP fittings are mechanical fittings used for the below-ground transition between a plastic service line and a copper riser for use in a residential application. There are approximately 400,000 AMP fittings in Enbridge's system. The copper piping downstream of the AMP fitting is subject to internal corrosion.
[30] Exhibit B2-2-1, pages 5 and 7.
[31] Exhibit B2-2-1, pages 7 and 42 to 56.
[32] Exhibit B2-2-1, pages 39 to 40.

23. Taken together, the system size and complexity factors outlined above add significantly to the business and financial risks faced by Enbridge. The Company's distribution system is growing older and larger. Costs associated with maintaining and updating the system are increasing, and are increasingly difficult to predict. At the same time, pipeline integrity standards are more stringent, and are expected to become even more so.[33] Changes in temperature trends and volatility, changes in customer mix, and changes in gas supply dynamics make peak day planning more difficult.[34] All of these risks are significantly more pronounced, and better understood, than was the case in either 1993 or 2006.

24. Enbridge's evidence with respect to environmental and technical advancements brings out changes in policy and laws that are aimed at decreasing greenhouse gas emissions and reliance on fossil fuels and increasing opportunities for renewable energy sources.[35] Taken together, these items add to uncertainty about the future of Enbridge's gas distribution business in Ontario. As Concentric stated in testimony, the combination of environmental regulations which signal the desired phase-out of carbon-emitting energy sources, and Ontario policies such as the *Green Energy Act* emphasize renewable and conservation over traditional fossil resources, and create uncertainty for gas planning, subject to the shifts in energy policy.[36]

25. Changes in attitude and approach to fossil fuels in Ontario can be seen in many places. For example, the preamble to the *Green Energy Act, 2009*, states as follows:

> The Government of Ontario is committed to fostering the growth of renewable energy projects, which use cleaner sources of energy, and to removing barriers to and promoting opportunities for renewable energy projects and to promoting a green economy.[37]

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[33] Exhibit E2-1-2, paras. 19 to 22 and Exhibit B2-2-1, pages 39 to 40 (Asset Plan).
[34] Exhibit A2-1-1, page 21.
[35] See, for example, Exhibit E2-1-2, pages 7 and 8 and 1Tr.8 and 141 to 142.
[36] 2Tr.17.
[37] *Green Energy Act, 2009*, S.O. 2009, c. 12, Sch. A.

26. On a national level, the National Round Table on the Environment and the Economy (NRTEE), a body established pursuant to a Federal Government statute to identify, promote and explain practices and principles of sustainable development[38] has also looked at the future role of fossil fuels in the Canadian economy.

27. The "Technology Roadmap to Low Greenhouse Gas Emissions in the Canadian Economy" report prepared for the NRTEE filed as part of Exhibit J2.1 lays out a roadmap for deep reductions in Canadian greenhouse gas emissions and discusses how these reductions would affect the major sectors of the Canadian economy. In this context, the report notes that two main energy end-uses, space heating and water heating, produce almost all residential greenhouse gas emissions.[39] The report goes on to envisage a scenario in which the "[t]he main action to reduce greenhouse gas emissions in the residential sector is the adoption of electric space heating systems" and '[w]ater heating also becomes mostly electric".[40]

28. A further NRTEE report titled "The State of Climate Progress in Canada", issued in 2012 at the request of the Federal Minister of the Environment, includes this conclusion:

> However, given that our full analysis includes all likely policy actions by governments — large and small — the NRT can also conclude that Canada will not achieve its 2020 GHG emission reductions target unless significant new, additional measures are taken. More will have to be done. No other conclusion is possible.[41]

29. Concentric summarized the import of the observations in the NRTEE report as follows:

> … Canada is not on the path to achieve its goals at the federal level or at the provincial level, and some significant changes are going to have to be made in the consumption of fossil fuels in order to comply with these regulations. And it goes without saying that the impacts on gas distributors are likely to be significant.[42]

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[38] *National Round Table on the Environment and the Economy Act*, S.C. 1993, c. 31, at section 4: http://laws-lois.justice.gc.ca/eng/acts/N-16.4/FullText.html .
[39] Exhibit J2.1, Attachment 1, page 40 of 145.
[40] Exhibit J2.1, Attachment 1, page 43 of 145.
[41] Exhibit J2.1, Attachment 2, at pages 6 and 112 of 176.
[42] 2Tr.18.

30. More broadly, Enbridge's evidence with respect to significant changes in its business risk was confirmed by Concentric.[43] Concentric agreed that many of the items described above demonstrate that "Enbridge is faced with new and challenging risks since they came before the Board in 2007 on this issue".[44]

31. Further, Concentric compared Enbridge's business risk to other Canadian and U.S. gas distributors by creating a proxy group of Canadian and U.S. companies with operations in regulated natural gas distribution businesses and with profiles comparable to Enbridge. Concentric screened these proxy group companies based on their business profiles, regulated revenues and credit ratings and then went deeper in the analysis at the operating company level by screening exclusively for large gas distribution companies with over 800,000 customers and credit ratings of A-minus or better. For each company, Concentric evaluated business risk through the degree of regulatory protection and measured exposure to potential uncertainties such as regulatory lag, commodity price risk, volumetric risk and the recovery mechanism for capital investments. Concentric found that, of the ten companies in the proxy group, some had comparable risk to Enbridge and some had less risk, but none had more risk than Enbridge. Each of the companies in the proxy group has a higher equity thickness than Enbridge, which means, in essence, that Enbridge is exposed to greater financial risk than its Canadian and U.S. competitors.[45]

32. Enbridge also provided empirical evidence indicating that the view taken by the markets is that Enbridge's risk has increased since 2007. Mr. Yaworsky's testimony on this point was as follows:

> …if we take a look at 2007, where we issued a 10-year bond – which I would argue is the most efficient part of the bond curve market – and the yield on that was 5.162, and if we step forward to 2010 for a same 10-year debt instrument, it was 4.045.
>
> …we track our spread indication information extremely closely. We have 15 years' worth of data from all of the Canadian debt capital issuers' markets. And I

[43] 2Tr.16-19.
[44] 2Tr.16. The reason why the date of the EB-2006-0034 case (which considered Enbridge's equity ratio) is referred to as both 2006 and 2007 is that the case was filed in 2006, but not determined until 2007.
[45] 2Tr.15-16.

> would just tell you that in 2007, our spread over the underlying cost of funds was – on average for that year was 65 basis points.
>
> Year-to-date, today, it is 110 basis points, which suggests that the market is viewing us as, arguably, 40 basis points more risky.[46]

33. Based on the foregoing, it is clear that there have been significant changes in Enbridge's business and financial risks and it is appropriate for the Board to reassess Enbridge's equity thickness in this case.

34. Importantly, Dr. Booth agrees that conditions are appropriate for a reassessment of Enbridge's equity thickness in this proceeding. With the support of each of the four intervenors in the Consortium, Dr. Booth asserts that Enbridge's current equity thickness is too high, and should be reduced to 35%. Dr. Booth's testimony at the hearing in this regard was as follows:

> MR. CASS: So I would take it, then, that as far as you know those parties that I have just named [VECC, CME, CCC and SEC] are supporting your recommendation that the Board set Enbridge Gas Distribution's equity thickness at 35 percent; right?
>
> DR. BOOTH: I would assume that they agree with my recommendations; correct.
> ....
> MR. CASS: Right. So clearly, in recommending 35 percent, you have accepted that the conditions are appropriate for the Board to reassess equity thickness in this case, haven't you?
>
> DR. BOOTH: That's correct.[47]

35. In short, Dr. Booth, on behalf of the four intervenors that sponsored his testimony, has acknowledged that this is an appropriate case for the Board to reassess Enbridge's equity thickness. Of course, this means that the parties that comprise the Consortium are in no position to contend that the Board should not undertake a reassessment of equity thickness. Having taken the position that Enbridge's equity thickness should be reduced, those parties must have accepted that there has been a significant change in financial, business or

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[46] 1Tr.77.
[47] 2Tr. 217-218.

corporate fundamentals. Otherwise, their argument for a reduction in Enbridge's equity thickness would not comply with that aspect of the Board's Cost of Capital Report.

E. THE FAIR RETURN STANDARD

36. As discussed above, the Cost of Capital Report leaves no doubt that the Fair Return Standard is a mandatory legal requirement that must be satisfied in any cost of capital determinations of the Board.[48] It was accepted by all of the expert witnesses in this case that the Fair Return Standard is the overriding standard that governs the determination of an appropriate equity thickness.

37. The Joint Written Statement that was prepared as a result of the experts' conference does not set out very many areas of agreement between Concentric and Dr. Booth. One item on which all experts agree, however, is that the Fair Return Standard applies to the determination of the appropriate equity ratio. In particular, the Joint Written Statement reflects the agreement of the experts that:

> The overriding standard for the OEB for determining the cost of capital is the Fair Return Standard. This standard is widely adopted across Canada by way of law and regulatory precedent. In order to make a determination of whether or not the Fair Return Standard is satisfied one needs to consider the allowed return as well as the equity ratio.[49]

Consistent with this view, the Joint Written Statement also includes the agreement of the experts that "[t]he common equity ratio and the rate of return are linked".[50]

38. The Joint Written Statement goes on to set out the agreement of the experts with respect to the components of the Fair Return Standard. In this regard, the Joint Written Statement contains the following proposition:

> The application of the Fair Return Standard can be viewed as having three requirements: comparability, financial integrity and capital attraction, which are corollaries of the opportunity cost principle.[51]

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[48] Cost of Capital Report, at pages i, 15 and 18.
[49] Joint Written Statement, Discussion Point 1A(2), at p. 10.
[50] Joint Written Statement, Discussion Point 9, at page 37.
[51] Joint Written Statement, Discussion Point 2A(2), at page 13.

39. The Comparable Investment Standard (comparability requirement) seeks to ensure that a utility's cost of capital (derived by taking into account both ROE and equity ratio) is comparable to the return available to enterprises of like risk. In discussing this requirement of the Fair Return Standard in the Cost of Capital Report, the Board concluded that "North American [Canada and US] gas and electric utilities provide a relevant and objective source of data for comparison".[52] The Financial Integrity Standard is intended to ensure that the financial integrity of the regulated enterprise is maintained. Stated differently, the requirement is that the return on capital must be sufficient to assure confidence in the financial soundness of the utility.[53] The Capital Attraction Standard is aimed at ensuring that the utility continues to be able to maintain and support its credit and raise capital necessary for its proper operations. The return on capital must be sufficient to permit incremental capital to be attracted on reasonable terms and conditions.[54]

40. In relation to the Fair Return Standard, the Board has made clear that all three requirements must be met. If a party is able to demonstrate that the Comparable Investment Standard has not been met in relation to the utility's cost of capital (ROE and equity thickness), then the Fair Return Standard is not satisfied.[55]

41. Concentric's evidence includes a full analysis based on the Fair Return Standard. Enbridge submits that Dr. Booth has not presented a comprehensive analysis that applies all requirements of the Fair Return Standard. The key differences between the evidence of Concentric and that of Dr. Booth in this area were summarized in the opening statement given at the hearing by Mr. Coyne.

42. The Board's Decision on Procedure for Oral Hearing of Concurrent Expert Evidence stated that each expert would be given an opportunity to make an opening statement, in lieu of examination in chief.[56] The Decision explicitly said that each expert would be expected, among other things, "to highlight the main areas of disagreement, including disagreements

[52] Cost of Capital Report, at pages 21 to 23.
[53] Cost of Capital Report, at pages 17 and 18.
[54] Cost of Capital Report, at pages 17 and 18.
[55] Cost of Capital Report, at pages 19 and 21.
[56] Decision on Procedure for Oral Hearing of Concurrent Expert Evidence, November 15, 2012, page 5.

of fact, methodology, and opinion that are relevant to the resolution by the Board of the issue". In his opening statement, Mr. Coyne followed the directions of the Board and addressed disagreements of fact, methodology and opinion. His testimony in this regard included the following:

> While we both accept the fair return standard as determinative for purposes of setting the cost of capital, our interpretations vary considerably.
>
> We believe that all three elements of the fair return standard must be satisfied, including the comparability, attraction and integrity standards.
>
> Dr. Booth focuses on the opportunity cost principle of the Lamont decision, and ultimately looks to the company's ability to attract debt capital as his measure. For all practical purposes, he ignores comparability, as he emphasizes this can only be measured with securities prices of equivalent risk, in essence, prohibiting an informed judgment by regulators on relative risks and comparable returns between utilities.[57]
>
> …
>
> We disagree with his narrow focus on the ability to raise debt capital. All three elements of the fair return standard must be satisfied.[58]
>
> …
>
> We have carefully evaluated EGDI's business and financial risk against other Canadian and U.S. gas distributors as a means of measuring comparability. Dr. Booth has not provided any such evidence.[59]

43. The experts did actually agree on certain Canadian utilities that can be used as comparators for the purposes of the issue before the Board in this proceeding. The Joint Written Statement sets out the agreement of the experts that, outside of Ontario, there are three utilities which can appropriately be compared to Enbridge for the purpose of determining equity thickness "without qualification". The three comparators are ATCO Gas, Fortis BC and Gaz Métro.[60]

44. Each of the three Canadian comparators that the experts agreed can be used "without qualification" has a higher equity thickness than Enbridge. Dr. Booth asserts that the higher equity thickness of these comparable Canadian utilities can be explained away by reference

[57] 2Tr.21-22.
[58] 2Tr.22.
[59] 2Tr.23.
[60] Joint Written Statement, Discussion Point 8(A)(1), at page 32.

to factors that are specific to each of them.[61] One difficulty with Dr. Booth's attempts to rationalize the higher equity ratio of the comparator utilities is that he does not take account of factors that would tend to indicate that the comparators are less risky than Enbridge. Such factors include, for example, revenue decoupling in the case of Fortis BC and mitigation of weather impact in the case of ATCO Gas.[62]

45. Furthermore, Dr. Booth freely proposes factors that in effect represent adjustments for Canadian utilities compared to Enbridge, while he dismisses the notion of using U.S. comparators, despite the relatively small sample size of good comparators from Canada.[63] In contrast, as discussed above, Concentric conducted a thorough and comprehensive screening and analysis in order to develop a proxy group of comparable Canadian and U.S. utilities and came to the conclusion that Enbridge's equity thickness is lower than that of all of the comparator utilities.[64]

46. One potential comparator that was referred to a number of times during cross-examination at the hearing is Union Gas Limited (Union). It is evident from the Board's recent decision in Union's 2013 rate case (EB-2011-0210), however, that Union is a problematic comparator for the purposes of this case. The equity thickness decision in EB-2011-0210 is very much one that was based on the evidence before the Board in that particular proceeding. This point about the evidence in EB-2011-0210 emerges throughout the Board's findings on the issue of Union's equity thickness, including the following:

> (1) "Union filed no evidence in this proceeding that demonstrates its business and/or financial risks have changed over the period that the IRM Settlement Agreement was in place."
>
> (2) "Union has filed no evidence to support [its] position that the deemed equity ratio was not correct and the Board therefore gives this argument little or no weight."

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[61] 2Tr.182-183.

[62] Exhibit JT2.19, at page 3 of 5.

[63] Exhibit L1, at page 74. Dr. Booth's dismissal of US comparators is at odds with the Board's determination from the Cost of Capital Report (as noted above) that Canadian and US gas and electric utilities provide a relevant and objective source of data for comparison of cost of capital items.

[64] Exhibit E2-2-1, at pages 28 to 34 and 2 Tr. 23.

(3) "[With respect to comparable Canadian utilities] neither Union nor the intervenors filed analytical evidence that demonstrated that these utilities are of like risk to Union. Rather what evidence was presented was anecdotal, ad hoc, and incomplete."

(4) "[With respect to increases in the common equity ratios of other Canadian utilities], no evidence was filed in this proceeding that set out the risks that resulted in findings supporting higher common equity for these utilities and no evidence was filed that demonstrates Union faces similar risks."[65]

47. In short, the Board made it abundantly clear that its decision with respect to Union's equity thickness turned on the nature of the evidence that was before the Board in EB-2011-0210. Enbridge submits that an equity thickness outcome that is so fundamentally tied to the Board's concerns about the evidence before it in the particular case provides no useful point of reference for what the Board would or should consider to be an appropriate equity thickness in a situation where different evidence is put before the Board.

48. The fact is that meaningful comparators for the purposes of determining an appropriate equity thickness for Enbridge can be found within Ontario.

49. Dr. Booth accepts[66], and indeed the experts agree[67], that electricity transmitters are less risky than natural gas distributors. While this supports a conclusion that Enbridge's equity ratio should be higher than that of an electricity transmitter like Hydro One Networks Inc. (HONI), HONI's equity ratio is 40 per cent.[68]

50. In testimony, Enbridge put forward a number of cogent reasons in support of a conclusion that electricity distributors are less risky than gas distributors:

> We see that Enbridge's business is riskier than the electric distribution business, certainly, as well as the transmission business, due to a number of factors.

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[65] EB-2011-0210 Decision and Order, pages 48-49.
[66] 2 Tr. 206.
[67] Concentric's agreement with this proposition is seen in the Joint Written Statement, Discussion Point 8(D), at page 36.
[68] In his testimony, Dr. Booth acknowledged that HONI's equity ratio, like that of other Ontario LDCs, is 40%: 2Tr.180.

> Number one, over a long period of time gas demand has been declining, while electric demand has been increasing.
>
> Number two, gas demand has only one seasonal peak, whereas electric demand has two seasonal peaks.
>
> Number three, gas demand is driven by one main component, and that is space heating, whereas electric demand is driven by a wide and varied end usage.
>
> As noted in the evidence, we also highlight Dr. Cannon's views in 1998, when cost of capital was being first established for the electric utilities. And his views were essentially that gas is riskier than electric, and we share that view.[69]

51. While Dr. Booth asserts that the equity ratios applicable to electricity and natural gas distributors are too high, Dr. Booth clearly accepts that electricity and natural gas distributors are of approximately equivalent risk,

> MS. CHAPLIN: And, Dr. Booth, have you performed any particular analysis of the current differential in risks between Ontario gas distributors and Ontario electricity distributors?
>
> DR. BOOTH: Not since I think it was the 2006 hearing, when that point, I recommended 35 percent common equity ratio for the electric distributors, exactly the same as I recommended for gas distributors.
>
> There are some differences in business risk, but the important point is that regulation basically harmonizes those risks. So what the shareholder sees is essentially exactly the same. [70]

52. Given that electricity distributors in Ontario have an equity ratio of 40%, a fair application of the Fair Return Standard should result in an increase in Enbridge's equity ratio to at least that level.

F. CONCLUSION

53. Enbridge has presented evidence, as has Concentric, showing a significant increase in Enbridge's business and financial risks and, in any event, Dr. Booth in his evidence given on behalf of the Consortium has accepted that conditions are appropriate for a reassessment of

[69] 1Tr.8-9.
[70] 2Tr. 179.

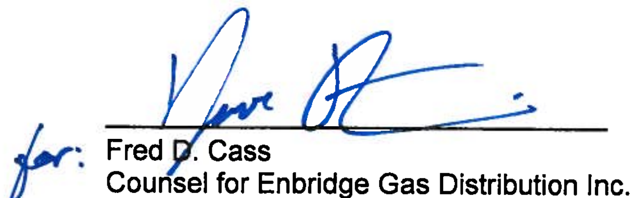
Enbridge's equity thickness in this case. This reassessment of Enbridge's equity thickness brings into play the Fair Return Standard, as confirmed in the Joint Written Statement filed with the Board by all of the expert witnesses on the equity thickness issue. For the reasons given above, the evidence in this proceeding establishes that Enbridge's current 36% common equity level does not meet the Fair Return Standard.

54. Concentric's analysis produces a recommended equity thickness for Enbridge in the range of 40 to 45 per cent; Concentric's expert opinion is that Enbridge's proposed equity ratio of 42 per cent would bring Enbridge in closer alignment with its industry peers and support the maintenance of an A- credit rating.[71] Further, in relation to the proposed equity ratio of 42 per cent, Concentric's evidence is as follows:

> We believe by increasing EGDI's equity thickness from 35 percent to 42 percent as requested by the Company, and adopting the ROE produced by the newly adopted ROE formula, the Board will have arrived at a cost of capital that is fair to EGDI. This recommendation is supported by our ROE analysis, which indicates an appropriate range of equity to be within 40-45 percent at the level of allowed ROE currently produced by the formula. Our recommendation is similarly corroborated by the ROE results of the Canadian regulated utilities group.[72]

55. Enbridge's Cost of Capital evidence was prepared on the basis of its request for a 42% equity level. Assuming that this request is approved, Enbridge submits that the forecast cost of debt and mix of short and long term debt and preference shares as set out in Part 1 of Appendix A to the revised Settlement Agreement[73] is appropriate and should be approved.

All of which is respectfully submitted, November 30, 2012.



for: Fred D. Cass
Counsel for Enbridge Gas Distribution Inc.

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[71] Exhibit E2-2-1, page 3.
[72] Exhibit E2-2-1, page 36.
[73] Exhibit N1, Tab 1, Schedule 1, Appendix A, Part 1, page 9 of 9.