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By electronic filing

December 7, 2012

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
27th floor
Toronto, ON M4P 1E4

Dear Ms Walli,

Enbridge Gas Distribution Inc. ("EGD") 2013 Rates	
Board File No.:	**EB-2011-0354**
Our File No.:	**339583-000132**

Please find enclosed the Written Argument of Canadian Manufacturers & Exporters ("CME") in the above-noted proceeding.

Yours very truly,

Peter C. P. Thompson, Q.C.

PCT\slc
enclosure
c. Robert Bourke (EGD)
Intervenors EB-2011-0354
Paul Clipsham (CME)

OTT01: 5406056: v1

EB-2011-0354

IN THE MATTER OF the Ontario Energy Board Act 1998, S.O. 1998, c.15, (Schedule B) (the "Act");

AND IN THE MATTER OF an application filed 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.

ARGUMENT OF CANADIAN MANUFACTURERS & EXPORTERS ("CME")

December 7, 2012

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I N D E X

I. **INTRODUCTION & OVERVIEW** 1

II. **BOARD'S CURRENT CAPITAL STRUCTURE POLICY FOR GAS UTILITIES** 4

III. **NEITHER THE BUSINESS NOR FINANCIAL RISKS OF EGD HAVE SIGNIFICANTLY INCREASED SINCE 2006** 12

- A. **Time Frame for Measuring Alleged Changes in Risks** 12
- B. **Measurement of the "Significance" of Emerging Risks Related to Cost of Capital** 15
- C. **Comparability** 20

IV. **CONCLUSION** 21

V. **FUTURE PROCEEDINGS PERTAINING TO THE BOARD'S CURRENT POLICY** 22

VI. **COSTS** 23

I. INTRODUCTION & OVERVIEW

1. For the purpose of deriving its rates for the 2013 test year, Enbridge Gas Distribution Inc. ("EGD") asks the Board to approve an increase in the Equity Ratio of its deemed Capital Structure from 36% to 42%. The requested 42% Equity Ratio will support utility Rate Base other than Customer Information System ("CIS") and Customer Care Rate Base. An agreement EGD made less than two years ago is based on a premise that a 36% deemed Equity Ratio is appropriate for its utility investments in CIS/Customer Care assets for a period expiring in 2018.[1] Adjusting for the deemed Equity Ratio of 36% supporting CIS/Customer Care investment, the overall deemed Equity Ratio EGD asks the Board to approve is 41.90%.[2] If granted, the requested Equity Ratio increase will add almost $22M[3] to the 2013 Revenue Requirement which the Board has approved in its 2013 Interim Rate Order dated November 29, 2012.

2. To support its request, EGD relies on evidence from company witnesses and from Concentric Energy Advisors Inc. ("Concentric"). Concentric is represented by James Coyne and Julie Lieberman. Mr. Coyne considers himself to be an expert in a broad range of utility matters.[4] His CV, found at Tab 13 of Exhibit K1.3, indicates that he largely, but not exclusively, represents the interests of utility owners in regulatory proceedings. Mr. Coyne, while already working for EGD in connection with a Benchmarking Study, was consulted to determine whether EGD had a viable case for seeking an increase in its Equity Ratio.[5] Concentric provided input into the development of the presentation made to EGD's Executive Management Team in July 2011.[6] That presentation was subsequently supplemented with an oral presentation from Concentric to the Management Team made later in the year. The initial presentation to EGD's

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[1] Transcript Volume 1, p.71, line 18 to p.72, line 20.
[2] Exhibit I, Issue E1, Schedule 7.1, p.3
[3] See Part 1 of Exhibit N1, Tab 1, Schedule 1, Appendix A, showing a revenue deficiency, at a 42% Equity Ratio, of $17.9M versus Part 2 of the same Exhibit showing a revenue sufficiency of $4.0M at a 36% Equity Ratio.
[4] Transcript Volume 2, p.5, lines 13 to 17.
[5] Transcript Volume 1, p.51, line 12 to p.52, line 3.
[6] Exhibit K1.3, Tab 7.

Executive Management Team in July 2011 included a recommendation that a case be prepared to be presented to the OEB for higher Equity Thickness and that Concentric be retained to "represent" EGD.[7]

3. Intervenors oppose EGD's Equity Ratio increase request on the grounds that EGD, being a gas utility that the Board regulates, has not satisfied the explicit requirements of the Board's current Cost of Capital policy. CME, Consumers Council of Canada ("CCC"), the School Energy Coalition ("SEC"), and the Vulnerable Energy Consumers Coalition ("VECC") asked Dr. Laurence Booth to provide an opinion on EGD's proposal to change its Capital Structure, having regard to the Board's approach to setting Capital Structure in accordance with the Report of the Board on Cost of Capital for Ontario Regulated Utilities dated December 11, 2009 (EB-2009-0084) (the "December 2009 Report").[8] Dr. Booth is an internationally renowned professor whose main interest is teaching domestic and international corporate finance. His research centers on the Cost of Capital, empirical corporate finance and capital market theory.[9]

4. The Board's current policy explicitly states that a gas utility seeking an increase in its deemed Equity Ratio must demonstrate that there has been a significant increase in its utility-specific business and financial risks since the Board last considered the appropriateness of the Equity Ratio in that particular utility's capital structure. The Board last considered EGD's Equity Ratio in a rates proceeding that took place in 2006 for a 2007 test year. The Board's Decision in that proceeding dated July 5, 2007, increased EGD's deemed Equity Ratio from 35% to 36%.[10]

5. Despite the contention of the Concentric witnesses that certain aspects of the Capital Structure features of the Board's current Cost of Capital policy are "flawed" and contain

[7] Exhibit K1.3, Tab 7 at p.9.
[8] Dr. Booth's Pre-Filed Evidence at p.3, lines 16 to 22.
[9] Exhibit K1.3, Tab 17.
[10] EB-2006-0034 Decision with Reasons – Phase I, July 5, 2007, Exhibit K1.4, Tab 2.

items of "unfinished business",[11] EGD's witnesses and its counsel unequivocally acknowledge that the Board's current policy applies.[12] They acknowledge that EGD is not asking the Board, in this case, to review or vary that policy. Accordingly, it is common ground that the Board's current Cost of Capital policy applies to a determination of EGD's Equity Ratio increase request. Based on these acknowledgements, the matters in dispute are:

(a) The appropriate interpretation of the Board's current policy with respect a request by a gas utility for an increase in its deemed Equity Ratio; and

(b) Whether the evidence adduced by EGD is sufficient to justify the requested Equity Ratio increase.

6. For reasons that follow, we submit that, contrary to Concentric's argument,[13] the Fair Return Standard is not a concept that supersedes and overrides the Board's current Cost of Capital policy. Until such time as it is reviewed and varied, the Board's current policy embodies the manner in which the Fair Return Standard is to be applied in determining the Cost of Capital components of rates of OEB regulated utilities, including EGD. Absent a demonstration by EGD that its business and/or financial risks have significantly increased between 2007 and 2012, as required by the policy, the Fair Return Standard is met through the combined effect of the existing Equity Ratio at 36% and the rate of Return on Equity ("ROE") derived from an application of the formula described in the policy statement.

7. For reasons that follow, we submit that the Board's current Cost of Capital policy places an onus on EGD to adduce convincing and objective evidence that its utility-specific business and/or financial risks have significantly increased over the period 2007 to 2012, being the period of time that has elapsed since the Board fixed EGD's Equity Ratio at

[11] Exhibit E2, Tab 2, pp.17 and 18.
[12] Transcript Volume 1, p.34, line 3 to p.36, line 2; p.78, line 20 to p.82, line 4; Transcript Volume 2, p.92, lines 12 to 16.
[13] See for example, Transcript Volume 2, p.107, line 24 to p.110, line 13.

36%. We submit that the Board's current policy cannot reasonably be interpreted otherwise.

8. Moreover, for reasons that follow, we submit that, taken as a whole, the objective capital market evidence convincingly demonstrates that EGD's utility-specific business and financial risks have not significantly increased since 2006. Those risks have decreased; with the result that EGD's request for a deemed Equity Ratio increase is unjustified and should be denied.

II. BOARD'S CURRENT CAPITAL STRUCTURE POLICY FOR GAS UTILITIES

9. The December 2009 Report provides guidelines with respect to a gas utility's Capital Structure. The December 2009 Report states, at page 50:

> ***"For electricity transmitters, generators and gas utilities, the deemed capital structure is determined on a case-by-case basis. The Board's draft guidelines assume that the base capital structure will remain relatively constant over time and 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 risk."***

10. The utility-specific risk-based approach described in this statement of the Capital Structure change policy for gas utilities is not new. Requiring a utility-specific demonstration of significant changes in business and/or financial risks has been an element of the Board's determination of deemed Equity Ratios of the gas utilities it regulates for more than 30 years.[14]

11. The Board has been regulating gas utilities, including EGD and its predecessors, for more than 50 years.[15] The Board adopted the hypothetical stand-alone utility Capital Structure model as a regulatory tool more than 30 years ago. As Dr. Booth explained in his presentation, the use of this regulatory tool involves the setting of an initial deemed

[14] Transcript Volume 1, p.16, line 19 to p.17, line 22. Also see Dr. Booth's helpful presentation of the history of the Board's long-standing use of the methodology, including the rationale for that approach at Transcript Volume 2, p.25, line 19 to p.42, line 8, and as summarized in Exhibit K2.1 at pp.1-6.

[15] Transcript Volume 1, p.15, lines 14 to 18.

Equity Ratio for the utility on the basis of business and financial risk considerations and then changing that deemed Equity Ratio only when significant changes in those utility-specific business and/or financial risks have occurred.[16]

12. This long-standing approach to a determination of Equity Ratios for gas utilities was practiced by the Board for years and then embodied in Draft Guidelines for a Formula-Based Return on Common Equity for Regulated Utilities issued by the Board in March 1997. Since that time, the Board has used a formula-based methodology to determine the ROE for gas utilities. That ROE is then combined with the utility-specific risk-based Equity Ratio of utility capital structure to derive the overall Equity Return for use in setting gas utility rates. This utility-specific risk-based determination of Equity Ratios for gas utilities was expressly endorsed by the Board in its December 2009 Report. This policy remains in full force and effect until such time as it is changed pursuant to the process for reviewing the Board's Cost of Capital policies specified at pages 63 and 64 of the Report in the chapter entitled "Annual Update Process and Periodic Review".

13. The Concentric witnesses effectively contend that, regardless of the extent to which the current utility-specific risk environment facing EGD differs from the environment it faced in 2006, it would be unfair for the Board to reject EGD's request for an increase in its Equity Ratio.[17] This unfairness assertion is based on a comparison of EGD's deemed Equity Ratio of 36% to comparators consisting of certain Canadian utilities with Equity Ratios higher than EGD, a sample of American entities with higher Equity Ratios than EGD, and the higher deemed Equity Ratio of 40% that the Board has established for the electricity distributors that it regulates.

14. Concentric contends that the Capital Structure aspects of the Board's Report requiring a utility-specific demonstration of significant changes in risk are "flawed" in that they

[16] See Footnote 13 above.
[17] Transcript Volume 2, p.99, lines 10 to 19; Transcript Volume 2, p.107, line 24 to p.110, line 13.

effectively fail to adjust the Equity Ratios of Ontario gas utilities upwards to be in line with the Equity Ratios of other utilities that Concentric regards as comparable to EGD. Concentric characterizes this failure of the Board's policy to change from a utility-specific demonstration of significant changes in risk to a comparability adjustment factor as an item of "unfinished business". Concentric asserts that in its December 2009 Report, the Board effectively "deferred on the issue of Capital Structure."[18]

15. The notion that the Board's December 2009 Report "left the Equity Ratio as an element of policy to be decided down the road" and "deferred on the issue of Capital Structure" with respect to gas utilities or any of the other utilities the Board regulates is incompatible with the context in which the Report was made, as well as its express wording.

16. With respect to context, we submit that the Board's December 2009 Report recognized that, unlike EGD and the other gas utilities that have been regulated by the Board for more than 50 years, electricity distributors and other electricity utilities only recently came under the auspices of Board regulation. As a result of their numbers, the distribution utilities needed to be regulated on a "batch" basis. The sheer numbers made it impossible for the Board to establish deemed Equity Ratios for electricity distributors, on a case by case basis, having regard to a utility-specific consideration of their business and financial risks. In other jurisdictions, such as Alberta, electricity utilities currently operate under the auspices of a 36% deemed Equity Ratio.

17. As Dr. Booth explained, the Board's initial approach to the Capital Structure for electricity distributors was a size-related Capital Structure model. Electricity distributors with a Rate Base having a value greater than $1B were assigned a 35% Equity Ratio. For utilities with between $250M and $1B of Rate Base, the assigned Equity Ratio was 40%. For utilities with Rate Base values ranging between $100M and $250M, the assigned Equity

[18] Transcript Volume 2, p.91, lines 8 and 9, and p.109, line 27 to p.110, line 1.

Ratio was 45%, and for utilities with less than $100M of Rate Base, the assigned Equity Ratio was 50%.[19] For electricity distributors, this size-related Capital Structure approach prevailed from 1999 to 2006.

18. In December 2006, the Board determined that a 40% Equity Ratio was appropriate for all electricity distributors.[20] The Board's initial and subsequent approaches to establishing the Capital Structure Equity Ratios for electricity distributors were adopted prior to the Board's 2007 Decision increasing EGD's Equity Ratio from 35% to 36%.

19. In the December 2009 Report, the Board's approach to electricity distributors is specifically mentioned in the paragraph that precedes the paragraph stating that significant changes in utility-specific business and/or financial risks will remain the policy for determining requests for change in the deemed Equity Ratios of gas utilities.

20. Having regard to the foregoing sequence of events that preceded the Board's adoption of a 36% Equity Ratio for EGD and its express continuance of utility-specific changes in risk as the basis for evaluating Capital Structure change requests made by gas utilities, Concentric's argument, that the Board's retention of the utility-specific risk-based criteria for evaluating the Equity Ratios of gas utilities was an oversight and a flaw in the December 2009 Report that comprises an item of unfinished business, is an argument that is completely discredited by the express language of the Board's December 2009 Report. The Board specifically stated in the Capital Structure section of its Report, at page 49, as follows:

> ***"The Board's current policy with regard to capital structure for all regulated utilities continues to be appropriate."*** **(emphasis added)**

The Report then goes on to specify that its current policy with respect to the Capital Structure of gas utilities calls for an application of the utility-specific significant change in risks approach. The Report reiterates this specification in a summary table that appears

[19] Exhibit K1.4, Tab 4, Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors, December 2006, at pp.3 and 4.

[20] Exhibit K1.4, Tab 2, EB-2006-0034 Decision with Reasons – Phase 1, July 5, 2007.

towards the end of the document at page 59, being a Schedule that includes "Capital Structure" as a component of the Board's Cost of Capital Policy. Based on the foregoing, we submit that no one can credibly contend, as Concentric does, that the Board, in its December 2009 Report, "deferred on the issue of Capital Structure."

21. Moreover, if the Fair Return Standard supersedes components of the Board's Cost of Capital policy, as Concentric argues, then the policy statement does not achieve one of its prime objectives, being to simplify the hearing process. Under the interpretation of the December 2009 Report that Concentric advocates, anyone can conduct an end-run around the Board's policy by asserting, on a case-by-case basis, that the outcome of applying the Board's policy does not satisfy the Fair Return Standard.

22. Vice-Chair Chaplin's questioning of the Concentric witnesses at Transcript Volume 2, page 110, line 17 to page 116, line 7 and at page 208, line 18 to page 211, line 12 focused on these implications of Concentric's interpretation of the Board's December 2009 Report. Under the interpretation Concentric advocates, an assertion by anyone in any rate case that the outcome of applying the Board's Cost of Capital policy does not satisfy the requirements of the Fair Return Standard inevitably leads to a full-scale analysis of the Cost of Capital components in that case. This outcome is incompatible with the spirit and intent of establishing a Board policy to simplify the Board's consideration of Cost of Capital issues in successive cases. The interpretation that Concentric places on the Board's December 2009 Report effectively renders the policy meaningless. We reiterate our submission that the policy embodies the Fair Return Standard. The Fair Return Standard does not supersede any component of the policy as Concentric argues. The interpretation Concentric urges should be rejected.

23. The "full and comprehensive review" of the application of the Fair Return Standard to EGD's Cost of Capital conducted by Concentric, to which EGD refers in paragraphs 7 and 41 of its Argument-in-Chief, stems from Concentric's distorted misinterpretation of

the Board's December 2009 Report, as does EGD's criticism of Dr. Booth for failing to conduct such an assessment.

24. Dr. Booth should be complimented, rather than criticized for preparing his evidence in accordance with the Board's policy and limiting his analysis to the question of whether EGD's utility-specific business and/or financial risks have materially increased since 2006. It is Concentric that should be criticized for distorting the plain and ordinary meaning of the Board's December 2009 Report to justify its attempt to conduct an end-run around the Capital Structure change features of the policy that are applicable to gas utilities, such as EGD. A primary purpose of the Board's policy was to avoid full and comprehensive analyses of the type that EGD compliments Concentric for presenting in this case.

25. For all of these reasons, we submit that, for it to justify its request for an increase in its deemed Equity Ratio, EGD must demonstrate that its utility-specific business and/or financial risks have significantly increased since the Board fixed its Equity Ratio at 36% in 2006. Any contention otherwise lacks credibility.

26. EGD's argument to the effect that the evidence of Dr. Booth opens the door to a complete re-assessment of EGD's risks, up or down, lacks merit and should be rejected.[21] The requirement of demonstrating significant increases in business and/or financial risk to justify an Equity Ratio increase request is not satisfied by evidence that demonstrates that such risks have decreased rather than increased since the Board established EGD's 36% Equity Ratio as EGD argues. The fact that Dr. Booth acknowledges that <u>decreases</u> have taken place in EGD's business and financial risks since 2006 which are of sufficient significance to warrant a reduction in EGD's Equity Ratio from 36% to 35% does not absolve EGD from the requirement of demonstrating significant <u>increases</u> in risk to justify its request for an Equity Ratio increase. Absent a

[21] EGD's Argument-in-Chief, paras.7, 34 and 35.

demonstration of significant increases in EGD's utility-specific business and/or financial risks over the period 2007 to 2012, EGD's Equity Ratio increase request must be denied.

27. A comparison of EGD's Equity Ratio to higher equity ratios of other utilities is of no consequence absent a demonstration that the differential that currently exists between EGD's Equity Ratio and the equity ratios of others is having a demonstrably adverse effect on EGD's ability to attract capital on reasonable terms. To be clear, any widening of the differential between EGD's deemed Equity Ratio and the equity ratios of other entities that has occurred since 2006, but does not have an adverse effect on EGD's ability to attract capital on reasonable terms, is of no consequence.[22]

28. This is not to suggest that, when considering an Equity Ratio increase request, the widening of that differential that may have occurred since the Board last examined EGD's Equity Ratio could never affect EGD's ability to attract capital on reasonable terms. It is possible that a continued widening of that differential could eventually alter the capital markets' perception of EGD's business and/or financial risks to a sufficient degree to detrimentally affect EGD's access to capital on reasonable terms. However, to demonstrate that such a widening of the differential is having such an effect requires objective capital market evidence that EGD is having to pay more to attract and obtain financing on reasonable terms.

29. The evidence in this case is entirely to the opposite effect. The evidence in this case indicates that, despite its deemed Equity Ratio of 36%, EGD is able to obtain financing at rates equivalent to or less than rates paid by utilities allegedly comparable to it with higher Equity Ratios, deemed or otherwise.[23]

[22] Because the objective capital market evidence convincingly demonstrates that whatever widening that has taken place between the percentage value of EGD's Equity Ratio and the percentage values for the Equity Ratios of entities that Concentric alleged are comparable to EGD, we consider it unnecessary to engage in a debate as to whether all of the entities upon which Concentric relies are appropriate comparables to EGD.

[23] Exhibit K1.2 and Transcript Volume 1, p.74, line 1 to p.76, line 3.

30. This objective capital market evidence demonstrates that the capital markets regard EGD, with its 36% Equity Ratio, to be of equivalent or lesser risk than other utilities with higher equity ratios. Put another way, the objective capital market evidence reveals that an upward adjustment to EGD's Equity Ratio is not needed to achieve risk comparability between EGD and other utilities with higher equity ratios. The market already regards EGD to be of comparable or lower risk than those other entities.

31. As already noted, the Fair Return Standard is not a concept that supersedes and overrides the Board's current Cost of Capital policy. Rather, the Board's current policy embodies the manner in which the Fair Return Standard is to be applied in determining the Cost of Capital components in EGD's rates. In the absence of a demonstration of significant increases, between 2007 and 2012, in its utility-specific business and financial risks, the Board's current policy provides that the Fair Return Standard is met by a combination of EGD's existing Equity Ratio of 36% and the ROE value determined pursuant to the elements of the formula specified in the Board's Policy Statement.

32. As a matter of policy, the Board has adhered to its utility-specific risk-based approach for determining the equity ratios of the gas utility it regulates. The Board has not adopted a formulaic approach for deriving equity ratios for any of the utilities it regulates.[24] Under the Board's current policies, it is risk considerations and only risk considerations that are applied to determine the appropriate equity ratio for EGD.

33. Based on a proper interpretation of the Board's current Capital Structure policy applicable to gas utilities, the question for the Board to determine in this case is whether the evidence supports EGD's contention that its business and/or financial risks have

[24] The Equity Risk Premium ("ERP") methodology to which the Board adhered in its December 2009 Report incorporates the utility-specific risk-based criterion for establishing and evaluating requested changes to the Equity Ratios of the gas utilities that the Board regulates. This long-standing approach to the equity component of the Capital Structures of gas utilities is not an formulaic or After-Tax Weighted Average Cost of Capital ("ATWACC") type of approach which appears to have some influence on Mr. Coyne as indicated in the exchange with Ms Sebalj at Transcript Volume 2, p.193, line 7 to p.194, line 19 and with Ms Chaplin at Transcript Volume 2, p.201, line 17 to p.211, line 14.

significantly changed since 2006. If they have not, then under the Board's policy, the Fair Return Standard is satisfied. EGD's request for an Equity Ratio increase must be denied.

III. NEITHER THE BUSINESS NOR FINANCIAL RISKS OF EGD HAVE SIGNIFICANTLY INCREASED SINCE 2006

A. Time Frame for Measuring Alleged Changes in Risks

34. The first point to consider is the time frame over which the alleged increases in risks are to be measured in accordance with the Board's policy.

35. In prior proceedings, EGD acknowledged that the alleged increases in risks should be measured from the date at which the Equity Ratio being challenged was last considered by the Board and extent to the time when the Board was considering the Equity Ratio increase request.[25]

36. In 2006, when EGD sought an increase in its Equity Ratio from 35% to 38%, its expert witness, Dr. Carpenter, who is still providing expert risk assessment evidence,[26] listed and addressed increases in risks it faced by EGD that had emerged between 1993, the year in which the Board last considered EGD's Equity Ratio, and 2006, the date of the Board's hearing of EGD's Equity Ratio increase request.[27] Dr. Carpenter's August 2006 evidence in EGD's EB-2006-0034 proceeding is found as Attachment 1 to Exhibit I, Issue E2, Schedule 21.9. At question 4, at page 2 thereof, the question posed was:

> **QUESTION:** "What is the basis for the 1993 reference date for this evaluation?"

Dr. Carpenter responded:

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[25] See Exhibit K1.3, Tab 12 being EGD's Pre-Filed Evidence in the 2006 proceeding pertaining to its request for an increase in its Equity Ratio.

[26] See Transcript Volume 2, p.41, lines 14 to 21 where Dr. Booth describes Dr. Carpenter as a business risk expert. It is noteworthy that EGD did not retain Dr. Carpenter to provide an assessment of any changes that have occurred in the risks facing EGD in 2012 compared to those facing EGD in 2006.

[27] Exhibit I, Issue E2, Schedule 21.9, Attachment 1.

> **ANSWER:** "It is my understanding that 1993 correspondence was the last time the Board considered a change in the company's equity thickness that involved an evaluation of the company's business risk. …"

Dr. Carpenter goes on in answer 5 to summarize his conclusion:

> "… that equity investors would consider investment in the company to be significantly more risky today than it was in 1993. …"

Dr. Carpenter specifically identifies the items that, in his view, comprise the sources of the increases in risk facing EGD that emerged between 1993 and 2006, and includes in his testimony a "then and now" analysis of each of those sources of increased risk.

37. The company evidence in that case, found at Tab 12 of CME's Compendium marked as Exhibit K1.3, similarly contains a listing and description of the various items giving rise to EGD's allegations that its risks were increasing. The evidence goes on to describe adverse effects that these allegedly increasing risks were having on EGD's ability to access capital and included information pertaining to EGD's declining interest coverages and information pertaining to its credit ratings, and the impact of weather on earnings. It concludes with a comparison of EGD's Equity Ratio to the equity ratios of other Canadian utilities.

38. In this case, under the leadership of Concentric, EGD has chosen to depart from a pragmatic "incremental" approach to the period over which alleged increases in risks should be measured, being the approach followed by EGD and Dr. Carpenter in the 2006 proceeding. In this case, neither EGD nor Concentric listed or measured alleged changes in risks from 2006 onwards. Rather, they initially abandoned the incremental approach that is compatible with the Board's policy and in accordance with the incremental approach followed by EGD in previous proceedings. Instead, EGD and Concentric adopted what is described in evidence and argument as "the long view" of increases in risks facing EGD. EGD purports to measure changes in risks from 1993

onwards and does not limit itself to the extent to which risks have emerged to 2012. It adds its views on prospective risks that could emerge well beyond 2012.

39. In responding to interrogatories, EGD declined to apply an "incremental" approach and refused to differentiate between the changes in risks that occurred between 1993 and 2007 and 2007 to date.[28]

40. In cross-examination, Concentric witnesses were pressed to explain how their long term view of risks, emanating from a point that pre-dated the Board's last examination of EGD's Equity Ratio by some 13 years and extended indefinitely into the future, was compatible with the Board's Cost of Capital policy. During his examination by Ms Chaplain, Mr. Coyne eventually conceded that, pursuant to the Board's policy, the primary focus of the inquiry should be from the date of the Board's last examination of EGD's Equity Ratio to the hearing of EGD's current request for an Equity Ratio increase. Mr. Coyne conceded that evidence pertaining to changes in risks outside of that time period were merely to be regarded as "context".[29] We submit that this "context" is irrelevant to a consideration of increases in risks that have allegedly emerged following the Board's last consideration of EGD's Equity Ratio in 2006. It is "context" that is deserving of little or no weight.

41. Notwithstanding the concession in cross-examination that the portions of the long term view that lie outside the parameters of the 2007 to 2012 time frame are merely "context", EGD continues to argue that the adoption of a long term view for measuring alleged increases in risk is appropriate.[30] EGD apparently proposes that a rolling 20 year timeframe be used to periodically assess changes in the business risks that it faces.[31] We submit that it is inappropriately duplicative to keep revisiting, in successive cases, risks faced by EGD in prior years the Capital Structure implications of which have

[28] Exhibit K1.3, Tab 10.
[29] Transcript Volume 2, p.94, line 5 to p.95, line 7; also p.99, lines 3 to 5.
[30] EGD's Argument-in-Chief, paras.13 and 14.
[31] Transcript Volume 1, p.161, lines 22 to 26.

already been considered by the Board in prior proceedings. We submit that such an approach is impractical and incompatible with the spirit and intent of the Board's Cost of Capital policy, the purpose of which is to simply the hearing process and to reduce the need for complex annual risk assessments. We submit that the "incremental" approach to risk assessments heretofore acknowledged by EGD as appropriate is the correct approach to apply.

42. For these reasons, we submit that the long term approach that EGD apparently insists on pursuing is inappropriate and should be rejected. The Board should focus on alleged increases in risks that have occurred since 2006.

B. Measurement of the "Significance" of Emerging Risks Related to Cost of Capital

43. The next item to consider is the criteria that should be applied when assessing whether any alleged increases in risk are "significant". In this connection, We submit that it is important to emphasize that the "significance" of any increases in risk should be measured in relation to EGD's ability to attract capital on reasonable terms.[32]

44. EGD classifies its alleged increases in risks in three (3) broad categories, namely:

(a) Volumetric demand profile;

(b) System size and complexity; and

(c) Environmental and technological advancements.

Regulatory tools, other than increasing the Equity Ratio of utility Capital Structure, are generally used to address these matters. Such tools include Board approval of increased capital spending, the increased recovery of fixed costs in the Customer or Demand Charges in rates, and Deferral and Variance Accounts.

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[32] The Board's December 2009 Report at page 20 recognizes the prime importance of a utility's ability to attract capital on reasonable terms in the context of achieving an outcome that is fair. There, the Board stated:

> *"… the Board is of the view that the capital attraction standard, indeed the FRS in totality, will be met if the cost of capital determined by the Board is sufficient to attract capital on a long-term sustainable basis given the opportunity costs of capital."* (emphasis added)

45. Within each of those broad categories, there is a long list of items that EGD asserts are increasing its risks. However, such assertions are largely subjective and unaccompanied by any objective capital market evidence pertaining to the effect, if any, that EGD's alleged items of risk increase are having on its ability to attract and obtain capital on reasonable terms.

46. It is noteworthy that EGD's Board of Directors apparently authorized the company to seek approval for an increase in its Equity Ratio in this case and to retain Concentric to "represent" EGD in that initiative[33] without considering any written presentation of capital market indicators relevant to a consideration of whether current risks facing EGD are adversely affecting its ability to attract capital on reasonable terms, compared to the situation that prevailed in 2006.[34]

47. No written presentation was made to EGD's Board of Directors with respect to any of the following:

(a) EGD's over-earnings 2007 to 2012 versus 2006;

(b) Interest coverage ratios 2007 to 2012 versus 2006;

(c) The continuance of its A bond rating since 2001; and

(d) The series of financings that it made 2007 to 2012, and the costs thereof compared to costs paid by utilities with equity ratios greater than EGD; and

(e) The duration of such issues which most recently are for a period of up to 40 years.

48. EGD's witnesses contend such metrics are irrelevant to a determination of its request for Equity Ratio increase.[35] We disagree. We submit that merely providing a list of changes that have emerged in the risk environment EGD currently faces, compared to the risk environment it faced in 2006, coupled with a subjective assertion that the risk

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[33] Exhibit K1.3, Tab 7, Slide 9.
[34] Transcript Volume 1, p.49, line 5 to p.50, line 17.
[35] Transcript Volume 1, p.51, line12 to p.54, line 14.

environment faced today has increased over the risk environment faced in 2006 is evidence deserving of little or no weight in determining whether the risk environment EGD currently faces today is significantly greater, in a Cost of Capital context, than it was in 2006. We submit that, for alleged changes in the risk environment facing EGD to be found to be of significance in the setting of EGD's Equity Ratio, the alleged changes in risk must be accompanied by objective capital market evidence demonstrating that the risk environment that has emerged is having a negative effect on EGD's access to capital on reasonable terms.[36]

49. In assessing the significance of a plethora of items in the risk environment currently facing EGD that allegedly differ from the elements of the risk environment facing EGD in 2006, it is important to focus not on the number of items listed but on the objective evidence, if any, establishing how the capital market perceives the current risk environment facing EGD.

50. In that connection, we submit that the following evidence overwhelmingly establishes that the capital markets perceive EGD's risks to be very low and, if anything, lower than they were in 2006:

- Historic Overearnings – EGD's normalized returns have consistently exceeded its allowed returns.
- Overearnings between 2007 and 2012 – Actual overearnings for the period 2007 to 2011 before overearnings were $241.5M and after earnings sharing, $185M;[37]
- Interest coverage ratios – For the period 2007 to 2011 inclusive, actual interest rate coverages range between 2.4 and 2.5, being ratios in excess of the ratios that prevailed from 1993 to 2006;[38]

[36] See Exhibit K1.3, Tab 12, and EGD's Pre-Filed Evidence in its 2006 case where EGD presented objective information related to the effects that its alleged increases in risks were having on matters pertaining to its attraction of capital on reasonable terms.

[37] Exhibit K1.3, Tab 14, Attachment 1, line 6; Exhibit K1.3, Tab 14, Attachment 1, line 20; Exhibit K1, Tab 15, Attachment 1, line 6; Transcript Volume 1, p.54, line 15 to p.55, line 22.

- Financing costs over the past 5 years compared to costs incurred by utilities with higher equity ratios;
  - o EGD's actual average debt rates for 2010 and 2011 were well below the long-term debt rate calculated under the auspices of the Board's Cost of Capital policy using an average spread with an A- rated long-term utility bond yield;[39]
  - o Compared to Union, the average actual debt costs that EGD achieved for 2010 and 2011 of 5.124% and 4.708% were less than the average annual debt costs achieved by Union for the same years of 5.27% and 4.93%;[40]
- Duration of loans, most recent being 40 years – EGD's most recent debt financing is at a fixed rate for a term of 40 years which, as Dr. Booth observed, is proof positive of the market's assessment of EGD's stability as an extremely low risk utility;[41]
- Consistent A rating despite Enbridge Inc.'s activities.[42]

51. The foregoing objective capital market evidence is corroborated by information contained in Exhibit K1.2 showing EGD's issuance of bonds in 2010 at rates comparable or better than the rates obtained by ATCO and Fortis Inc., being utilities with Equity Ratios greater than EGD's Equity Ratio of 36%.[43]

52. In Argument, EGD relies on Mr. Yaworsky's evidence to the effect that the "average" spread in 2007 of 65 basis points has increased to an "average" spread today of 110 basis points. It is not clear whether this is an "average" spread for EGD only, or for Enbridge Inc. and all of its subsidiaries, including EGD. In Argument, EGD invites the

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[38] Exhibit K1.3, Tab 12, p.19; Exhibit K1.3, Tab 3, p.2; Transcript Volume 1, p.56, line 11 to p.57, line 20.
[39] Exhibit K1.3, Tab 3 at pp.3-4; Transcript Volume 1, p.58, line 22 to p.61, line 11.
[40] Exhibit K1.3, Tab 3, p.5; Exhibit K1.3, Tab 4; Transcript Volume 1, p.61, line 20 to p.64, line 1.
[41] Transcript Volume 2, p.51, line 9 to p.52, line 9.
[42] Transcript Volume 1, p.72, line 21 to p.73, line 27; Evidence of Dr. Booth at Transcript Volume 2, p.50, line 23 to p.51, line 3.
[43] Transcript Volume 1, p.74, line 1 to p.76, line 2.

Board to infer from this "average" spread information that the market perceives EGD's business risks to have increased since 2006.

53. The evidence pertaining to actual EGD issues in Exhibit K1.2 shows that, in 2007, EGD issued a 10-year note at a spread of 110 basis points and in 2010, issued another note in the same amount for the same term at an issue spread of 90 basis points. The actual spread information in the record pertaining to issues made by EGD in 2007 and subsequently does not corroborate the 45 basis points increase in "average" spreads to which Mr. Yaworsky refers. The information in Exhibit K1.2 is supposed to include all the debt issues made by EGD in 2007 and subsequent years.

54. Moreover, as Dr. Booth testified,[44] any increase in spreads that has occurred since 2007 does not reflect increases in risk but reflects the fact that there is a huge amount of capital coming into Canada in the sovereign debt market. Dr. Booth's observation that an increase in spread is unrelated to risks appears to be corroborated by the information in Exhibit K1.2 where, in the case of ATCO, the spread on 30 year medium term notes in 2007 of 116 basis points increased to 160 basis points by 2011. The spread on ATCO's 40 year issue in 2012 is 150 basis points. For Fortis, the spread on a 40 year issue in 2007 of 125 basis points increased to 149 basis points by 2012.

55. Based on the foregoing, we submit that the "average" spread increase information provided by Mr. Yaworsky does not detract from the overwhelming effect of all of the other objective capital market information demonstrating that, in a Cost of Capital context, the risk environment EGD currently faces has not increased compared to the risk environment it faced in 2006. It has decreased.

56. For all of these reasons, we submit that by failing to focus on the appropriate time period from 2006 to 2012 for measuring alleged increases in risk and by failing to adduce any objective capital market evidence to support a conclusion that the risk environment EGD

[44] Transcript Volume 2, p.232, line 1.

currently faces today is adversely affecting its access to capital markets on reasonable terms, EGD is essentially in the same position as Union Gas Limited ("Union") was in its 2013 Rebasing case. Like Union, EGD has adduced no objective capital market evidence showing that its business and/or financial risks have increased over the period 2007 to 2012, being the period of EGD's Incentive Regulation Mechanism ("IRM") Settlement.

57. EGD acknowledges that the risk environment that it faces is not markedly different than the risk environment Union faces. In its 2013 Rebasing case, Union acknowledged that its overall risk profile has not materially changed since 2006. In this case, EGD refuses to make such an acknowledgement, despite the fact that the objective capital market evidence convincingly demonstrates that, from a capital market perspective, EGD is better off today than it was in 2006. Having regard to such evidence, the Board should not hesitate to find that EGD's business and/or financial risks have not significantly increased since 2006.

C. <u>Comparability</u>

58. As already noted, the mere fact that EGD's Equity Ratio is lower than the deemed equity ratios of other Canadian utilities and the equity ratios of Concentric's sample of American entities is evidence that has no relevance to the Board's consideration of whether EGD's utility-specific business and/or financial risks have increased since 2006. Absent objective capital market evidence showing that the current differential between EGD's Equity Ratio and the equity ratio of others is having an adverse effect on its ability to attract and obtain capital at reasonable terms, the existence of that differential is of no relevance to an application by the Board of its utility-specific significant increases in risk policy.

59. Moreover, we reiterate that the fact that EGD, with an Equity Ratio of 36%, and can access capital on terms as favourable as those obtained by utilities with higher equity

ratios is evidence that demonstrates, convincingly, that the capital markets regard EGD with a 36% Equity Ratio to be of equivalent or lesser risk than the other utilities having higher equity ratios. From a capital market's perspective, EGD is regarded as comparable to those other utilities without there being any upward adjustment to its Equity Ratio.

IV. CONCLUSION

60. No evidence has been presented that supports a finding that EGD's business and/or financial risks have significantly increased since 2006.

61. Dr. Booth's acknowledgement that EGD's business and financial risks have decreased to a sufficient degree to justify a reduction in EGD's Equity Ratio does not relieve EGD of the burden of establishing that its business and/or financial risks have significantly increased since 2006 so as to justify its Equity Ratio increase request. The Board's utility-specific risk-based approach for determining equity ratio increase requests is a component part of the application of the Fair Return Standard in Ontario in accordance with the Board's Cost of Capital Policy. The Board's policy embodies the Fair Return Standard. As EGD's witnesses conceded, the Board's policy and the Fair Return Standard are one and the same.[45]

62. Since EGD is unable to establish the pre-requisites necessary to justify an increase in its Equity Ratio, the combination of its existing Equity Ratio and the Board's Formula ROE satisfies the Fair Return Standard.

63. The notion that, without an increase to its Equity Ratio, EGD is not comparable to other Canadian utilities having higher equity ratios is discredited by the objective capital market evidence establishing that EGD, at a 36% Equity Ratio, is considered by the

[45] Transcript Volume 1, p.35, line 21 to p.36, line 2.

capital markets to be of equivalent or lesser risk than other entities having higher equity ratios.

64. Even though we agree entirely with Dr. Booth that EGD's business and financial risks have declined over the period 2007 to 2012, the relief we seek in this proceeding is limited to a denial of EGD's request for an Equity Ratio increase. The interim rates approved by the Board on November 29, 2012, should be made final.

V. FUTURE PROCEEDINGS PERTAINING TO THE BOARD'S CURRENT POLICY

65. For reasons already outlined, Concentric's argument that, for gas utilities, the Cost of Capital features of the Board's current policy are "flawed" and an item of "unfinished business" is a contention that is incompatible with the context and express wording of the Board's December 2009 Report.

66. Similarly, Concentric's contention that the Fair Return Standard is a concept that supersedes the Board's Cost of Capital policy is an argument that is without merit. The Board's policy embodies the Fair Return Standard. In the words of EGD witnesses, the policy and the Fair Return Standard are one and the same.

67. We reiterate that EGD's witnesses and its counsel have acknowledged that EGD is not seeking, in this case, a review or variance of the Board's December 2009 Cost of Capital policy. That said, if EGD wishes to seek rectification of alleged flaws" or items of "unfinished business" in the Board's December 2009 Report, then it is free to do so in a proceeding initiated to review the Board's current Policy. Concurrently, the Board can consider any submissions that other parties may wish to make to the effect that the ROE Formula established in the Board's December 2009 Report is too generous and should be revised.

68. All assertions by utilities and others to the effect that aspects of the Board's current Policy are in need of review and variance should be considered during the course of the review processes contemplated in the Board's December 2009 Report, including the initial 5-year review that the Board plans to conduct in 2014 for implementation in rates in 2015.

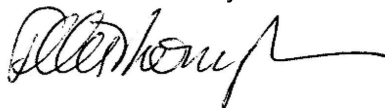
VI. COSTS

69. We request that CME be awarded 100% of its reasonably incurred costs of participating in this proceeding.

70. We question whether it is appropriate to allow EGD to recover the costs that it has incurred for Concentric's Cost of Capital services in the amount of some $386,000.[46]

71. In considering the extent to which these costs for services rendered by Concentric with respect to the Equity Ratio issue, should be recoverable from ratepayers, we invite the Board to consider that these services were primarily, if not exclusively, provided for the purpose of attempting to recover an extra $22M for the benefit of EGD's shareholder. One method that the Board might consider for determining the extent to which Concentric's bill for services rendered to EGD should be recoverable from ratepayers is to limit that recovery to an amount that the Board eventually assesses as costs for the services that Dr. Booth rendered in providing his expert testimony with respect to the Equity Ratio issue.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 7th day of December, 2012.



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[46] Exhibit J1.1.