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.
REPLY ARGUMENT

A. INTRODUCTION

1. On November 30, 2013, Enbridge Gas Distribution Inc. (Enbridge, or the Company) submitted its Argument in Chief in this proceeding. Enbridge received submissions in response to its Argument in Chief from Board Staff and from the following intervenors: Building Owners and Managers Association Toronto (BOMA), Canadian Manufacturers & Exporters (CME), Consumer Council of Canada (CCC), Energy Probe Research Foundation (Energy Probe), School Energy Coalition (SEC) and Vulnerable Energy Consumers Coalition (VECC).

2. These are Enbridge's Reply submissions responding to the arguments received from other parties and from Board Staff. For the purposes of these Reply submissions, Enbridge repeats and relies upon the evidence that it has filed in this case and its Argument in Chief.

B. OVERVIEW

3. The Board's 2009 Cost of Capital Report confirmed that the "over-arching principle", and 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. Enbridge's evidence in this case sets out the changes in risks facing the utility. The evidence from Enbridge and its expert (Concentric) includes analysis and information about the equity thickness approved by North American regulators for utilities of comparable risk to Enbridge.

4. Enbridge believes that the application of the Fair Return Standard in this case will lead the Board to conclude that there is no justifiable reason for Enbridge's equity ratio to be lower than all electricity utilities in Ontario (which are all subject to the same ROE) or the range of comparable utilities across Canada and the United States identified by Concentric. In the result, Enbridge requests that its request for an increase in equity ratio from 36% to 42% be approved.

C. THE PROPER APPROACH

5. There seems to be confusion and disagreement over the approach that the Board should follow in examining the Company's request for an increase in equity ratio from 36% to 42%.

6. While all parties (including Enbridge) acknowledge the Board's comments in the Cost of Capital Report that a utility's capital structure will be reviewed only when there is a significant change in the business and financial risks facing the utility, a diversity of views has been expressed about the range of risks to be examined and about the application of the Fair Return Standard.

7. As explained in Argument in Chief, the Board's Cost of Capital Report makes clear 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).[1] As set out in the Cost of Capital Report, all three of these requirements of the Fair Return Standard must be met in any of the Board's determinations of cost of capital (which would include any determination of equity ratio), and none ranks in priority to the others. A focus on meeting the Financial Integrity Standard and

[1] Cost of Capital Report, at pages 18 and 19.

the Capital Attraction Standard without giving adequate consideration to the Comparable Investment Standard is not sufficient to meet the Fair Return Standard.[2]

8. Some parties (such as BOMA, SEC and Energy Probe) appear to conclude that the analysis of a gas utility's appropriate capital structure should be limited to looking at business and financial fundamentals and risks, and that the Fair Return Standard is not applicable to the evaluation of capital structure.

9. Other parties (such as CCC and CME) appear to acknowledge that the Fair Return Standard may be applicable to the analysis of appropriate capital structure, but conclude that the Fair Return Standard is necessarily met if the applicant cannot show changes in business fundamentals and risks.

10. Finally, in contrast to the other parties, Board Staff appears to assert that if the applicant can show that there are changes to its business and financial risks, then the Board would address "broader questions" through an "overarching review" (also referred to as a "further review"), to ensure that the Fair Return Standard is met in relation to the utility's cost of capital.[3] Board Staff also leaves open the possibility that the Board might "set aside" the "threshold question" of whether there are changes in business/financial risks (presumably in the case where significant changes in business risks were not shown) and proceed to fully consider an analysis of whether the Fair Return Standard is met.[4] Enbridge notes that the approaches noted by Board Staff are largely consistent with the suggestions made by the Company's expert, Concentric Energy Advisors (Concentric).[5]

11. Given the range of opinions around the issue, it is important as a preliminary matter to set out the approach that Enbridge believes the Board should follow in evaluating the Company's request for an increase in equity ratio from 36% to 42%.

[2] Cost of Capital Report, at page 19.
[3] Board Staff Argument, at pages 11 to 12.
[4] Board Staff Argument, at page 12.
[5] See, for example, 2Tr.10-12.

12. As a first matter, Enbridge acknowledges the Board's expectation that an applicant seeking adjustment to its capital structure should demonstrate that there has been a significant change in its business and/or financial risks. This is consistent with the Board's policy set out in the Cost of Capital Report, which states, among other things, that[6]:
    a. The deemed capital structure of a utility is determined on a case-by-case basis; and
    b. A reassessment of a utility's capital structure "should" only be undertaken in the event of significant changes in the company's business and/or financial risk (also referred to as financial, business or corporate fundamentals).

13. Enbridge takes this policy to mean that the Board will consider, based upon the specific circumstances that apply to the applicant, whether there has been a significant change in the business and financial risks facing that utility. In Enbridge's view, there are a number of key matters for the Board to take into account in undertaking this review:
    a. The utility's own circumstances must be examined; it is not enough to draw comparisons to other utilities and conclude that because their risks are unchanged the same must hold true for the applicant;
    b. The change in the utility's cost of capital relative to comparable utilities constitutes a financial risk that must be examined; and
    c. The evaluation of the risks facing the utility should be looked at from a long-term perspective, to include consideration of risks that may materialize over the coming years as well as current risks.

14. As to the types of changes of business and financial risks that the Board should consider, the Company's witness, Mr. Lister, made clear that this should include both "absolute" and "relative" changes in business risks.[7] The first of these categories (absolute changes) includes business risk items with direct impact on Enbridge. There are three types of such changes addressed in Enbridge's Argument in Chief, and below (changes in demand profile; increases in system size and complexity; and environmental and technological advances). The second of these categories (relative changes) looks at the utility's relative standing compared to other utilities because a utility that is no longer comparable to utilities of like

[6] Cost of Capital Report, at pages 49 to 50.
[7] 1Tr.34-36.

risk in relation to its cost of capital will be subject to a change in its competitiveness (a financial risk) and a reassessment of capital structure by the Board is appropriate. This item, which implies a change in risk environment that may be external to the utility, was addressed by Concentric in its evidence.[8] Effectively, therefore, as stated by Mr. Lister, an evaluation of aspects of the Fair Return Standard (the comparability requirement) becomes part of the Board's exercise in determining whether to undertake a full reassessment of the utility's capital structure.[9]

15. Where it is found that the utility faces significant changes in business and/or financial risk, then the Board's Cost of Capital Report indicates that the Board will consider whether and how the utility's capital structure should be changed. In this regard, the Board is clear in the Cost of Capital Report that capital structure is part of a utility's cost of capital.[10] That is very significant in light of the Board's unequivocal determination that the Fair Return Standard "constitutes the over-arching principle for setting the cost of capital"[11]. It is a legal requirement that the Fair Return Standard be satisfied in any cost of capital determination. The Board has acknowledged this.[12] It follows, therefore, that the outcome from any review of a utility's capital structure must satisfy the Fair Return Standard. The Board confirmed this to be the case in its recent EB-2011-0210 Decision (re. Union Gas 2013 rates).[13]

16. Based on the foregoing, Enbridge takes issue with the conclusions of some parties, such as BOMA[14] and SEC[15] that the Fair Return Standard does not apply to the determination of a utility's capital structure. That position is not consistent with the guidance set out in the Board's Cost of Capital Report, as set out above.

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[8] See discussion in Argument in Chief, at paragraphs 30 to 31; see also 2Tr.19-20 and 2Tr.101-106.
[9] 1Tr.92, where Mr. Lister stated that the fair return standard is very much part of the Board's policy related to when it will undertake a re-examination of a utility's capital structure.
[10] See, for example, the inclusion of capital structure as part of the discussion of cost of capital at pages 59 and 61 of the Cost of Capital Report.
[11] Costs of Capital Report, page 15.
[12] Cost of Capital Report, at pages i and 18.
[13] Decision and Order in EB-2011-0210, October 24, 2012, at pages 49 to 50.
[14] BOMA Argument, at pages 32 to 43.
[15] SEC Argument, at pages 9 to10.

17. The position of parties such as BOMA and SEC is also not consistent with OEB and other Canadian regulatory decisions. For example, in the recent Decision and Order in Union's 2013 rates case the OEB expressly accepted that the determination of equity ratio, along with the cost of that equity, is governed by the non-optional Fair Return Standard.[16] OEB policy in this respect is consistent with regulatory policy in other Canadian jurisdictions. That is seen in a 2004 National Energy Board decision related to TCPL which noted that "In this hearing, the Board must apply its judgment to satisfy itself that the approved common equity ratio, when combined with the Mainline's ROE of 9.56 percent, will result in a fair return on equity for TransCanada in 2004."[17] The same point is made in the 2009 Alberta Utilities Commission Generic Cost of Capital Decision, which states: "Any discussion of allowed returns must necessarily consider both ROE and capital structure in assessing the comparability of utility returns in the U.S. and Canada."[18]

18. There are some comments in the intervenor arguments (for example CME[19]) about the interplay between the requirement that a utility must show changes in business/financial risks (referred to by some as the "threshold test") and the Fair Return Standard. CME appears to conclude that the Fair Return Standard must be seen to be met if Enbridge is unable to show significant changes in business/financial risks.[20] Enbridge disagrees.

19. Enbridge's position was made clear in an exchange between Enbridge counsel and Ms Chaplin, during which it was suggested that the case may arise where an applicant does not meet the "threshold test", yet the Board also finds that the Fair Return Standard has not been met.[21] In that case, the Board might find itself denying the applicant's request for a change in capital structure thereby putting itself in a position where its cost of capital decision does not meet the Fair Return Standard (which is a legal requirement and the "overriding standard"). With respect, Enbridge submits that this outcome cannot be what

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[16] Decision and Order in EB-2011-0210, October 24, 2012, at pages. 49 to 50.
[17] NEB Case RH-2-2004, Phase 2 (TCPL) at pages 17 to 20 (cited by both Concentric and Dr. Booth in the Joint Witness Statement).
[18] 2009 Alberta Utilities Commission Generic Cost of Capital Decision, November 12, 2009 (Decision 2009-216), at paragraph 192: found as Attachment 3 to Exhibit I-E2-14.1.
[19] CME Argument, at paragraphs 20 to 33.
[20] CME Argument, at paragraph 6 and 33.
[21] 1Tr.36-37.

was intended by the Board's Cost of Capital Report.[22] It appears that the Board reached the same conclusion in its Decision in the recent Union Gas 2013 rates case. In that Decision, the Board found that Union had failed to adduce evidence of changes to its business and financial risks, yet the Board did not dismiss Union Gas's request for an increase in equity thickness solely on that basis. Instead, the Board proceeded to consider whether Union had made the case that its equity thickness no longer met the comparability requirement under the Fair Return Standard. In taking this step, the OEB noted that "The Board's obligation to determine the quantum of common equity (at issue in this proceeding) and the cost of that equity (subject to the Settlement Agreement) is governed by the FRS, which is a non-optional legal standard".[23]

20. Based on all of the foregoing, Enbridge submits that the Board must take the Fair Return Standard into account in its consideration of the Company's request for an increase in its equity ratio.

21. As a final point on the proper approach (made in response to Board Staff submissions[24]), Enbridge notes that the Board's determination of whether the Fair Return Standard is met does not involve any balancing of interests between ratepayers and the utility. The only way that ratepayer impact should come into play is through the determination of how best to implement an updated equity thickness.[25]

D. CHANGES IN BUSINESS AND FINANCIAL RISKS

22. As explained above, and in Argument in Chief, Enbridge acknowledges the Board's expectation that a natural gas utility will demonstrate significant changes in business/financial risk before the Board will examine whether changes to the utility's capital structure are appropriate.

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[22] Concentric also reached the same conclusion, stating in testimony its belief that "it is consistent with Board policy that a reassessment of a utility's capital structure should be undertaken whenever there is a reasonable doubt that its capital structure, in conjunction with its allowed return, fails to meet the fair return standard": 2Tr.10

[23] Decision and Order in EB-2011-0210, October 24, 2012, at pages. 49 to 50.

[24] Board Staff Argument, at page 3.

[25] Cost of Capital Report, at page 19.

23. Enbridge's evidence sets out the "absolute" changes in business risks that it faces under three categories: (i) changes in demand profile; (ii) increase in system size and complexity; and (iii) environmental and technological advancements. The main aspects of each of these were highlighted in Argument in Chief, and are discussed in more detail in several key exhibits.[26] Contrary to the suggestion in CME's Argument[27], it is both appropriate and common that business risk evidence be provided by a utility (which is entirely familiar with its own circumstances, including business risks) in addition to evidence offered by a third-party expert.

24. Concentric's evidence sets out the "relative" risks for Enbridge in relation to comparable utilities. The key elements of this evidence were highlighted in Argument in Chief, and were also addressed in Concentric's testimony.[28] As Mr. Coyne explained "…we measured Enbridge's business risk versus industry comparables in Canada and the U.S., and based on a comparison to like business risk companies, it has an equity ratio that is not equivalent, and, therefore, it is exposed to more financial risk as a result of that versus its peer group."[29]

25. Mr. Coyne later explained the significance of this finding, noting that regulators should provide utilities of comparable risk with a comparable financial structure so that they can compete fairly in the marketplace and, in the case of electricity and gas utilities, fairly between each other without any unjustified differentials in capital structure that would distort price signals to consumers.[30] It is only the Board that is in a position to ensure that there is no unjustified differential in capital structure between Enbridge and Ontario's electricity distributors. While the Board has addressed Enbridge's ROE in relation to that of the electricity distributors, it has not done the same with capital structure.

26. Enbridge's view is that changes in business/financial risks must be considered from a long-term perspective. One of the implications of this approach is that the Board should take a long-term view, back to 1993, of how Enbridge's risks have evolved. More significantly,

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[26] See Argument in Chief, at paragraphs 13 to 30. See also Exhibit E2-1-2, pages 3 to 8; Exhibit E2-2-1, pages 18 to 34; Exhibit I-E3-1.3, Undertaking JT2.14 and Undertaking J1.3.
[27] CME Argument, footnote 26.
[28] See Argument in Chief, at paragraph 31. See also 2Tr.19-20 and 2Tr.101-106.
[29] 2Tr.103.
[30] 2Tr.104.

though, this approach also means that the Board should take into account the long-term view of how Enbridge's risks may develop and manifest themselves. Stated differently, in determining equity thickness (which is meant to apply for a period of several years or more), it is appropriate for the Board to take into account how the subject utility's risks will emerge and impact upon the utility's business.

27. The following paragraphs set out Enbridge's response to arguments advanced by other parties in relation to each of the identified areas of changes in business and financial risks.

(i) Changes in Demand Profile

28. Enbridge's evidence explains that it faces substantial business risks arising from anticipated continuation of declines in natural gas demand in its franchise over coming years, caused by ongoing declines in average use and increases in the price of natural gas as a commodity (gas prices).[31]

29. While intervenors (such as Energy Probe[32] and BOMA[33]) express skepticism about whether the decline in average use will continue, Enbridge's evidence demonstrates that this is a real risk based on historical experience, potential for higher gas prices and declining industrial demand. As explained in Argument in Chief[34], as average use declines the Company's costs are spread over smaller volumes which makes gas distribution relatively more expensive. Contrary to the suggestions from a number of intervenors[35], this issue is not ameliorated by the fact that a larger proportion of Enbridge's charges are now fixed rather than variable.

30. In its Argument, CCC suggests that any expectation of increases in gas prices is speculative, and should be discounted.[36] Enbridge disagrees, but notes that its fundamental

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[31] See, for example, Argument in Chief at paragraphs 16 to 19 (including the references cited).
[32] Energy Probe Argument, at pages 6 to 7.
[33] BOMA Argument, at pages 6 to 7.
[34] Argument in Chief, at paragraph 16.
[35] See, for example, Energy Probe Argument at page 7 and BOMA Argument at page 6.
[36] CCC Argument, at pages 4 to 5.

concern is not about gas prices, but about the fact that average use declines have continued even in the face of lower gas prices over recent years.[37]

31. In any event, Enbridge submits, based on the evidence filed in this proceeding[38], that concerns about rising gas prices are based on reasonable expectations and represent a real risk over the longer term. That is the case even with emerging new supply sources. As Mr. Lister stated in testimony, heightening environmental concerns make shale gas supply uncertain[39], and as Mr. Coyne stated in testimony, natural gas is an increasingly global commodity[40] meaning that emerging sources of supply may not continue to be available to the Ontario market at current prices.

32. The Company disagrees with CCC's assertion that the risk of increases in gas prices should be looked at in the "near term".[41] The point of examining changes in the Company's business risks is to look prospectively at challenges the Company may be facing over time that make the enterprise more risky. To the extent that capital structure is meant to be relatively stable over the long term, it is appropriate that the risks that inform whether the capital structure is appropriate should also be looked at over the long term.

33. Enbridge disputes the suggestion made by a number of intervenors that available "regulatory tools" manage the impact of declining average use.[42] While the deferral and variance accounts referred to by intervenors (such as AUTUVA and LRAM) may provide some near-term protection to Enbridge from associated revenue declines, these accounts do not cover all customer groups and do not ameliorate all short-term volume risk.[43] More importantly, such "regulatory tools" do not address the long-term implications of changes in the demand profile of Enbridge's customers. The combination of continued system growth, declining average use, diminishing industrial load and increasing "peakiness" of gas supply requirements increase Enbridge's risks.

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[37] See Argument in Chief, at paragraphs 17 and 18.
[38] See Argument in Chief, at paragraphs 18 to 20 (including the references cited), as well as 1Tr.9 and 110-112 and 2Tr.16.
[39] 1Tr.1-4-105.
[40] 2Tr. 16
[41] CCC Argument, at paragraph 20.
[42] See, for example, CME Argument at page 15 and BOMA Argument at pages 5 to 6.
[43] See Concentric response to Board Staff Interrogatory #1 on Issue E2 (Exhibit I-E2-1.1).

34. Many parties argue that the AUTUVA in particular shields the Company from the impacts of declining average use.[44] With respect, that is not true. While the AUTUVA affords protection from unexpected in-year declines in average use, it does not provide any shield against year over year changes in average use. Stated differently, the AUTUVA does not address the problem of declining demand for natural gas over the long term, it simply remedies in-year forecast error for consumption.

35. Finally, the Company disagrees with the assertions by Board Staff[45] that customer growth mitigates the risks faced by the Company. The addition of continuing numbers of mostly weather-sensitive residential customers to Enbridge's system means that the risk of declining average use and volatility in consumption arising from both weather conditions and gas prices is exacerbated.[46]

(ii) Increase in System Size and Complexity

36. Enbridge's evidence in relation to the increased risks it faces over the coming years from its growing and aging distribution system is clear.[47] As explained, the risk that Enbridge faces arises from the confluence of a number of factors including: an expanding and complex distribution system with many assets reaching end of life; new information about asset integrity issues; a new comprehensive Asset Plan that assesses all of the Company's distribution assets; evolving regulatory safety requirements for gas distributors; the increasing "peakiness" of gas demand (which drives the need for reinforcement and related work); recent incidents in North America (such as San Bruno); and requirements from very large gas-fired generation customers.

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[44] See, for example, VECC Argument at page 3, BOMA Argument at pages 5 to 6, and Energy Probe Argument at pages 5 to 7.
[45] Board Staff Argument, at page 8.
[46] 1Tr.165-166.
[47] See, for example, Exhibit E2-1-5, at paragraphs 17 to 23, and Argument in Chief, at paragraphs 21 to 23 (including the references cited).

37. These factors drive costs that are variable, unpredictable and significant. Ratings agencies have identified rising capital cost pressures as risk factors facing utilities.[48] The fact that the amount and timing of pending significant capital costs cannot be confidently foreseen causes uncertainty, which increases business risk. As Enbridge stated in an Interrogatory response, "[v]ariability in costs is directly relevant to business risk and was in fact a key reason for the recent downgrade of Enbridge Inc. … Variability in costs is not expected to diminish in the future, and in all likelihood will increase as distribution assets continue to age."[49]

38. CCC believes that the point about increased system size and complexity is simply an argument that capital expenditure needs are likely to be significant.[50] In fact, Enbridge's evidence described the implications of the size and complexity that its gas distribution system has already reached; the evidence did not relate to the size and complexity of the distribution system at a point in time in the future when further capital expenditures will have been made. With respect to the size and complexity of the distribution system that has already been reached, Enbridge now has an Asset Plan that provides detailed information about the state of the assets and the uncertainties associated with the condition and maintenance of those assets.[51] It is these uncertainties, as well as the overall magnitude of spending, around asset-related costs that cause the risks faced by Enbridge[52] (in other words, the risk is related to both the size of the capital spending and to the surrounding uncertainties).

39. Energy Probe takes issue with the notion that a distributor should be able to rely upon size of its system as a risk, stating that if system size is truly a risk then the Board should regulate the size of the distributor.[53] With respect, that is not reasonable or feasible. While

[48] See, for example, Moody's report at Exhibit I-E2-21.12, attachment 2, page 29 and Standard & Poors report at Exhibit I-E2-21.12, attachment 1, page 5.
[49] Exhibit I-E3-21.3, at page 3.
[50] CCC Argument, paragraph 25.
[51] The Asset Plan, which is a detailed document (over 60 pages in length) setting out the Company's forecast distribution asset requirements over ten years, is filed at Exhibit B2-2-1. As seen in that document, there are at least 19 different asset classes that Enbridge has identified as requiring further study in order to determine what remedial action/spending must be undertaken.
[52] See, for example, 1Tr.133-135 and Exhibit I-E2-21.12, Appendix A, page 5.
[53] Energy Probe Argument, at page 10.

it is true that the size of Enbridge's system increases capital costs and potential risks, that is no reason to limit the size of the enterprise. Enbridge has an obligation to serve its franchise areas (within which there is continuing growth of customer numbers), and this means that the size of the distribution system is expanding. Customers benefit from economies of scale as the system grows. The Board benefits from the large size of gas distributors, because there are relatively few to regulate.

(iii) Environmental and Technological Advancements

40. In its evidence and Argument in Chief, Enbridge described the ways in which changes in policy and technology are creating risks around future demand for natural gas.[54] This creates substantial uncertainty for Enbridge as it considers future demand and use for natural gas over the long term.

41. In response, Energy Probe asserts that technological advancements may lead to more efficient equipment and that it will take time for less carbon-intensive advancements to have an impact in the market.[55] With respect, Enbridge believes that these points support the Company's position. There is a clear long-term risk that demand for natural gas will decline, as new technologies and energy saving practices take further hold. The current impact of items such as replacement of less efficient appliances and new *Building Code* standards is described in Enbridge's Gas Volume Budget evidence.[56] These impacts will cumulate over time. Even if the magnitude of impacts cannot be known with certainty, it is a fair concern that these items will negatively impact natural gas demand in the future.

42. Several intervenors assert that Enbridge's concerns about government policy which would limit greenhouse gas emissions (and therefore gas use) are over-stated.[57] Enbridge disagrees. There are already a number of examples of legislative initiatives by the government of Ontario that take account of concerns about the effect of greenhouse gas emissions. These include amendments to the *Environmental Protection Act* which have been passed (but not proclaimed) and will allow for a "cap and trade" program to proceed in

[54] See, for example, Argument in Chief at paragraphs 24 to 29 (including the references cited).
[55] Energy Probe Argument, at page 11.
[56] Exhibit C1-3-1, page 4.
[57] See, for example, BOMA Argument at pages 9 to 10 and CCC Argument at pages 6 to 7.

Ontario.[58] Another example is section 10 of the *Green Energy Act*, which requires that greenhouse gas emissions be reported in connection with the construction, acquisition, operation and management of government facilities.[59] A third example is the requirement in a Regulation under the *Green Energy Act* that a "public agency" - including all municipalities, hospitals and school boards - prepare and publish an "energy conservation and demand management plan" to set out greenhouse gas emissions and energy consumption and plans for future conservation.[60] A fourth example is the "Greenhouse Gas Emissions Reporting" Regulation under the *Environmental Protection Act*, which requires facilities emitting more than 25,000 tonnes of CO2 equivalent per year to begin reporting their emissions in 2011.[61]

43. it is only to be expected that these requirements will increase over time. No other conclusion is possible, if Canadian governments are going to meet the commitments they have made to reduce greenhouse gas emissions. These types of government policies and direction represent a risk to gas distributors, as recognized by ratings agencies that cover Enbridge.[62]

44. As noted by Mr. Coyne, Ontario has a targeted reduction of 80% in greenhouse gas emissions from 1990 levels by the year 2050.[63] Current Government programs will not meet this target. More will have to be done. That is the conclusion of the 2012 National Roundtable on the Environment and the Economy Report on the State of Climate Progress in Canada.[64] The uncertainty around what steps will be taken to further reduce greenhouse gas emissions (which can be expected to include some focus on reducing natural gas use) represents a significant risk to Enbridge in coming years.

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[58] *Environmental Protection Act*, R.S.O., c.E19, section 176.1(4)
[59] *Green Energy Act, 2009*, S.O. 2009, C.12, Schedule A, at section 10.
[60] Energy Conservation and Demand Management Plans, O. Reg. 397-11.
[61] Ontario Regulation 452/09.
[62] The conclusion that gas distributors face risks from government requirements around greenhouse gas emissions and other climate change measures is supported by observations from ratings agencies which report on the financial and regulatory environment faced by gas distributors. See, for example, Standard & Poors Industry Survey re, Natural Gas Distributors (2010), at page 9 (Exhibit I-E2-21.3, attachment 1) and Standard & Poors Utility Sector Review (2011), at page 2 (Exhibit I-E2-21.12, attachment 1).
[63] 2Tr.19.
[64] Exhibit J21, Attachment 2, at chapter 4.

(iv) Financial risks

45. As explained in Argument in Chief, and in Concentric's testimony, Enbridget faces financial risk due to the fact that every one of the utilities that Concentric has identified as being comparable have higher equity thickness.[65] The impact is that there is unfair competition for investment capital.[66]

46. In response, CCC asserts that this ought not to be viewed as a risk because Enbridge has no difficulty attracting capital and achieving strong earnings.[67] CME makes a broader argument, asserting that any increases in Enbridge's risks should be measured in relation to Enbridge's ability to attract capital on reasonable terms.[68]

47. With respect, the point that the Company is making, as explained by Mr. Coyne, is a broader one, as seen in the following testimony:

> And I don't think it is the company's position that it is currently inhibited in accessing debt markets, but debt is only a piece of the capital that the company employs in its business.
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> We're here to determine the proper equity ratio, not whether or not the company can raise debt capital. And it goes to just one element of the fair return standard, and that's the ability to attract capital, and not even one full element. It is only half of it, and that is it goes to the debt piece.
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> It doesn't address the issue at all of comparability. And if you have -- my premise to you is that if you have two companies or two investments that have exactly the same business risk and you capitalize one with a lower equity ratio than the other, if you are a prudent investor, an equity investor, you would choose the one every time that gives you the greater security -- the greater security of more equity in that investment.
>
> So if you have utilities that are of comparable business risk, then you should be providing them, as a regulator, with a comparable financial structure so that they can compete fairly in the marketplace and fairly between each other, if you're

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[65] See Argument in Chief, at paragraph 31. See also 2Tr.19-20 and 2Tr.101-106.
[66] 2Tr.104.
[67] CCC Argument, at paragraph 51. .
[68] CME Argument, at paragraph 43.

> talking about electric and gas distributors. And that's the gap that we have identified here. It is not just about raising debt capital.[69]

48. Enbridge submits that this focus on comparability is appropriate. It does not, as CCC asserts[70], take away the Board's ability to make independent decisions. Instead, what is required is that the decisions that the Board does make must treat utilities fairly relative to cost of capital circumstances of comparable utilities. That this leaves the Board with latitude is seen in a passage from the Cost of Capital Report highlighted in Board Staff's submission.[71] This passage emphasizes that the Fair Return Standard (which includes the comparability requirement) "is sufficiently broad that the regulator that applies it must still use informed judgment and apply its discretion in the determination of a rate regulated entity's cost of capital".[72]

(v) Overall Submissions re Changes in Business and Financial Risks

49. Enbridge has provided a range of evidence setting out the changes in business and financial risks that it faces in 2013. The conclusion to be reached is that these are significant changes in risk, particularly when considered in light of how such risks may manifest themselves over the coming years. In the result, it is appropriate for the Board to undertake a full re-assessment of Enbridge's capital structure, with reference to whether Enbridge's current equity level of 36% satisfies the Fair Return Standard (and with reference to the level of equity thickness that will meet the Fair Return Standard).

50. As explained in Argument in Chief, Dr. Booth clearly sees a sufficient change in business/financial risk to justify a full re-assessment of Enbridge's capital structure: this was clear from his support for a decrease in Enbridge's equity ratio. CME acknowledges this position[73] (as one would expect from one of Dr. Booth's sponsors), and submits that the position is supported by decreases in Enbridge's business and financial risks "which are of sufficient significance to warrant a reduction in EGD's Equity Ratio". In Enbridge's view, this should be taken as an indicator that the threshold measure of what constitutes

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[69] 2Tr.104.
[70] CCC Argument, at paragraph 53.
[71] Board Staff Argument, at page 12.
[72] Cost of Capital Report, at page 18.
[73] CME Argument, at pages 9 to 10.

"significant changes" in business and financial risks has been met, although the parties and their experts disagree on the direction of those changes.

51. Surprisingly, SEC distances itself from Dr. Booth's recommendation, stating that SEC does not agree that this is an appropriate time to review Enbridge's equity thickness. That SEC expressly disagrees with the expert it sponsored is surprising in two ways: first, Dr. Booth was under the impression that all of the sponsoring parties supported his recommendation[74]; and second, in the recent Union Gas case in which Dr. Booth also testified, SEC supported a reduction in that Union Gas's equity thickness.[75]

E. THE FAIR RETURN STANDARD

52. CCC concludes its submissions on business risk with assertions that rely heavily on the evidence of Dr. Booth.[76] CCC's argument then moves on to address the Fair Return Standard and puts forward a position that is completely opposite to the view of Dr. Booth.[77] CCC argues that, in the Cost of Capital Report, the Board did not, either directly or even by necessary implication, suggest that the Fair Return Standard would be an overarching consideration in dealing with a change in capital structure. In the Joint Written Statement, however, under Discussion Point 1, which was concerned with the Board's Capital Structure Policy as set out in the Cost of Capital Report, Dr. Booth agreed with the following proposition:

> 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.[78]

53. SEC asserts that the opinions of the experts in this case about the Fair Return Standard ought to be given no weight, because this involves legal interpretation and interpretation of Board policies, which are outside their realm of expertise.[79] Enbridge disagrees. The

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[74] 2Tr.218.
[75] EB-2011-0210, Decision and Order, at page 46.
[76] CCC Argument, paragraphs 34, 35 and 41.
[77] CCC Argument, paragraph 45.
[78] Joint Written Statement, Discussion Point 1A(2), at p. 10.
[79] SEC Argument, at pages 4 to 5.

experts are well-versed in dealing with issues of utility cost of capital, and provide guidance to a variety of regulators in that regard. As such, the experts must be seen as having special knowledge and experience related to the standards and policies that dictate how utility cost of capital is to be addressed. The experts are very familiar with the contents of the Fair Return Standard and how it should be applied. In Enbridge's submission, the Board has already indicated that it views the experts' views about the Fair Return Standard as being important and relevant because it approved the issue of "Application of the Fair Return Standard" as being one of the listed discussion points to be addressed at the Experts' Conference.[80] That is consistent with the Board's use of expert evidence and opinions to inform the conclusions set out in the Cost of Capital Report.

54. As seen in the above discussion of the CCC and SEC Arguments, a troubling feature of the arguments from the "consortium" members who sponsored Dr. Booth is the selective way in which they refer to and rely upon his evidence. That is seen also in CME's Argument, which asserts that "the Fair Return Standard is not a concept that supersedes and overrides the Board's current Cost of Capital policy"[81] while making no attempt to rationalize that position with Dr. Booth's agreement that "the overriding standard for the OEB for determining the cost of capital is the Fair Return Standard".[82]

55. In summary, as agreed between the experts, and as made clear by the OEB and other Canadian regulators, any determination on a utility's cost of capital must satisfy the Fair Return Standard. As stated in the Joint Written Statement, "[t]he 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.[83]

56. CME's Argument asserts that no change in equity thickness is appropriate, because Enbridge shows no difficulty in attracting and obtaining capital at reasonable terms.[84] CME points to a number of factors in this regard, including Enbridge's earnings level and access

[80] Procedural Order No. 5, October 15, 2012, Appendix C (list of discussion points to be considered at the Experts' Conference).
[81] CME Argument, at paragraph 31.
[82] Joint Written Statement, Discussion Point 1A(2), at page 10.
[83] Joint Written Statement, Discussion Point 2A(2), at page 13.
[84] CME Argument, at paragraphs 43, 49 and 58.

to long-term financing.[85] Enbridge does not accept the premise of CME's argument. The fact that Enbridge has had strong earnings levels, and access to debt financing, does not diminish the prospective risks that it faces. Moreover, CME's position is at odds with the Board's comment in the Cost of Capital Report that "the FRS expressly refers to an opportunity cost of capital concept, one that is prospective rather than retrospective."[86] Finally, when the Board turns to consider whether Enbridge's current capital structure meets the Fair Return Standard, the Board must look not only at the financial integrity and capital attraction requirements, but also at the comparability requirement. As stated in the Cost of Capital Report, all three requirements must be met, and none ranks in priority to the others.[87]

57. In relation to the comparability requirement, CCC's Argument asserts that Enbridge has failed to provide a detailed analysis of the utilities that the Company says are comparable.[88] Enbridge disagrees. Both Enbridge and Concentric provided evidence around the comparability standard, including description of why the comparators used were chosen.

58. Concentric's evidence set out a list of 10 comparable utilities (based on risk and operations), and concluded that: (i) Enbridge's equity ratio (along with Union Gas's) is the lowest of this group, and (ii) an equity thickness range of 40% to 45% is appropriate for Enbridge. As explained by Mr. Coyne in his testimony, the process used by Concentric to identify and evaluate these comparables involved a "detailed analysis":

> We evaluated Enbridge's risk from both a business risk and a financial risk perspective. First, in business risk in relation to other Canadian and U.S. gas distributors, we created a proxy group of Canadian and U.S. companies with operations in regulated gas distribution businesses, with profiles comparable to Enbridge.
>
> We screened these companies based on their business profiles, regulated revenues and credit ratings to ensure we had a good fit. We estimated the cost of equity for these proxy companies, both Canadian and U.S. companies, so we could determine whether their combined equity ratios and ROEs were consistent with Enbridge's.

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[85] CME Argument, at paragraph 50.
[86] Cost of Capital Report, at page 19.
[87] Cost of Capital Report, at page 31.
[88] CCC Argument, at paragraph 52.

> We then went deeper in this analysis at the operating company level and screened exclusively for large gas distribution companies, those with over 800,000 customers, that had credit ratings of A-minus or better, which is EGDI's credit rating, resulting in a group of three Canadian and seven U.S. gas distributors we selected from a universe of nine Canadian and 108 U.S. gas distributors.
>
> For each company we evaluated business risk through the degree of regulatory protection and measured exposure to things like regulatory lag, commodity price risk, volumetric risk and the recovery mechanism for capital investments for each of these companies.
>
> There is disagreement between the experts here on the premise that U.S. utilities are treated differently than Canadian utilities by the regulators. Concentric in this proceeding has provided substantial evidence on this issue to the Board. We found, importantly, that of the ten company comparison group -- in this ten-company comparison group operating in 15 jurisdictions, that eight were found as having comparable risk to Enbridge and seven had less, but none had more risk than Enbridge.
>
> Concentric's comparison of the regulatory protection to EGDI to like companies illustrates that EGDI has no greater degree of protection even though it has a lower equity ratio, exposing EGDI to greater financial risk than its competitors.[89]

59. Enbridge's evidence elaborates on the reasons why Ontario electricity distributors are at least as risky as the Company, and explains how that justifies an equity thickness for Enbridge that is at least as high as the 40% that applied to Ontario electricity distributors.[90] In this evidence, and in oral testimony[91], Enbridge provides the justification for comparability of Ontario electricity distributors.

60. In relation to this issue of comparability, BOMA takes issue with whether Enbridge's risk is higher than Ontario electricity distributors. First, BOMA points to a 1998 paper prepared by Dr. Cannon for the OEB, as support for this position.[92] Second, BOMA relies on an OEB decision related to Natural Resource Gas (NRG) which found that NRG's size and profile is

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[89] 2Tr.14-16. Concentric's work product is filed as Exhibit E2-2-1.
[90] Exhibit E2-1-1, pages 9 to 11. Enbridge notes the suggestion in the CME Argument that Alberta electricity utilities have a 36% equity ratio – that is not accurate. As seen in the Alberta Utilities Commission decision reproduced at Ex. I-E2-14.1,(Attachment 3, page 19) the equity ratio for Alberta distribution utilities ranges from 39% to 41%, and 13 of the 16 listed utilities, including transmission utilities, have equity ratios above 36%.
[91] See, for example, 1Tr.8-9.
[92] BOMA Argument, at pages 11 to 12.

similar to a number of electricity distributors, and therefore it should have the same equity ratio (40%).[93]

61. Enbridge's view is that the items relied upon by BOMA actually provide support to the Company's request for a higher equity ratio.

62. The excerpts in BOMA's Argument from the Dr. Cannon paper include the statements that "Ontario's MEUs are marginally less risky, in terms of overall business risk exposure than gas LDCs" and "there is a remarkable similarity in the nature and pattern (if not always the intensity) of the business risks facing individual enterprises in the Ontario gas and electricity distribution industries". In the same vein, as set out in their Joint Written Statement, the experts in this case agree that electricity distributors are no less risky than gas distributors.[94] The implication here is that Enbridge's equity ratio should be at least as high as electricity distributors (40%).

63. The OEB's decision in relation to NRG's equity thickness can also be read as support for a higher equity ratio for Enbridge. That is seen in two related areas: (i) the Board has accepted that the equity ratio found in the OEB's cost of capital policy for electricity utilities can be applied to gas distributors; and (ii) Enbridge is not dissimilar in size and/or scope of operations to certain of the electric utilities that also have a 40% equity ratio (such as Hydro One Networks and Hydro One Transmission).

64. As a final point on this topic of comparability to Ontario electricity utilities, Enbridge notes that no party disputed or responded to the submissions made in Argument in Chief[95] setting out the agreement of the experts in this case that electricity transmitters (which have a 40% equity thickness) are less risky than gas distributors.

65. BOMA also asserts that Enbridge is less risky than gas distributors in the United States, setting out a lengthy argument asserting higher regulatory risks in the United States.[96] Enbridge disputes the implication that American utilities are not appropriate comparators in

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[93] BOMA Argument, at page 12.
[94] Joint Written Statement, Discussion Point 8(D), at page 36. Concentric sees gas distributors as having higher risk than electricity distributors, while Dr. Booth sees their risks as being equivalent.
[95] Argument in Chief, at paragraphs 48 and 49.
[96] BOMA Argument, at pages 20 to 32.

this case. Concentric has undertaken a detailed screening process to identify 10 gas distribution utilities (including 7 in the United States) with comparable business risk profiles. Part of that exercise was a "regulatory risk comparison".[97] This use of American comparables is consistent with the guidance provided by the OEB in its Cost of Capital Report:

> … there was a general presumption held by participants representing ratepayer groups in the consultation that Canadian and U.S. utilities are not comparators, due to differences in the "time value of money, the risk value of money and the tax value of money." In other words, because of these differences, Canadian and U.S. utilities cannot be comparators. The Board disagrees and is of the view that they are indeed comparable, and that only an analytical framework in which to apply judgment and a system of weighting are needed. The analyses of Concentric Energy Advisors and Kathy McShane of Foster Associates Inc. are particularly relevant in this regard, and substantially advance the issue of establishing comparability to meet the requirements of the FRS. Further, the Board notes that in the consultation session on October 6, 2009, Dr. Booth stated that it is "absolutely possible" to form a sample from a risky universe that is low risk and compare it to the universe or the population of Canadian utilities. All participants agreed.
>
> The Board notes that Concentric did not rely on the entire universe of U.S. utilities for its comparative analysis. Rather, Concentric carefully selected comparable companies based on a series of transparent financial metrics, and the Board is of the view that this approach has considerable merit.[98]

66. Finally, Board Staff's Argument notes that the Fair Return Standard allows some discretion to the Board in determining appropriate cost of capital.[99] As stated in the Cost of Capital Report, when applying the Fair Return Standard the Board must still use informed judgment and apply its discretion. Enbridge submits that the application of informed judgment in this case should lead the Board to conclude that there is no justifiable reason for Enbridge's equity ratio to be lower than all electricity utilities in Ontario (which are all subject to the same ROE) or the range of comparable utilities across Canada and the United States identified by Concentric.

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[97] Exhibit E2-2-1, Appendix B.
[98] Cost of Capital Report, at pages 21 to 22.
[99] Board Staff Argument, at page 12.

F. COMPARISONS TO UNION GAS

67. Intervenor arguments rely on the recent proceeding in which the equity thickness for Union Gas Limited (Union) was considered by the Board (EB-2011-0210). Enbridge submits that the Board should not accept these arguments by intervenors, for a number of reasons.

68. First, in the Cost of Capital Report, the Board indicated that, for gas utilities, the deemed capital structure is determined on a case by case basis.[100] Indeed, CCC asserts specifically that the focus in relation to capital structure is on the circumstances of the particular utility seeking the change.[101] Despite this recognition that equity thickness is a matter to be determined on a case by case basis, intervenors draw on evidence given in the Union proceeding regarding business risk as if that evidence is determinative of business risk issues for Enbridge.[102] Enbridge submits that the implication of intervenor arguments is that there is no meaningful opportunity for Enbridge to make its case on business risk to the Board once Union has given its evidence with respect to business risk. Enbridge submits that this approach by intervenors fails to respect the statement in the Cost of Capital Report that deemed structure is determined on a case by case basis and effectively means that evidence in another gas utility's case pre-determines the ability of Enbridge to put a case before the Board.

69. Second, Enbridge submits that reliance in argument on evidence from another proceeding is not appropriate. In this regard, Enbridge notes that Energy Probe repeatedly refers to evidence given by witnesses in the Union Gas proceeding in support of its arguments about the business risk of Enbridge.[103] Energy Probe even goes so far as to provide a reference to the transcript in the Union proceeding, just as if it is citing evidence properly on the record in this proceeding.[104] Not only does Energy Probe rely on evidence from another

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[100] Cost of Capital Report, page 50.
[101] CCC Argument, paragraph 9.
[102] See, for example, Energy Probe Argument, pages 4 and 5 and CCC Argument, paragraph 42.
[103] Energy Probe Argument, page 4, third paragraph; page 7, bottom paragraph; page 8, middle paragraph; page 12, second paragraph. See also CCC Argument, paragraph 42.
[104] Energy Probe Argument, page 7, bottom paragraph.

proceeding, its argument, in effect, is that such evidence should effectively "trump" the evidence of Enbridge that is on the record in this case about business risk.[105] Enbridge submits that this case should, and indeed must, be decided on the evidence on the record before the Board in this proceeding and not on the basis of evidence in some other case.

70. Third, Enbridge submits that the Board, when giving its decision in the Union case, was very careful to make clear that there were a number of areas where it found the evidence to be lacking. In Argument in Chief, Enbridge listed four different areas where, in its decision in the Union case, the Board made comments to this effect about the evidence.[106] In other words, the Board's decision in the Union case turned on the Board's view about the need for further evidence and was not a precedent on the equity thickness issue that has bearing on another case in which the evidence is different. Given that the Board rendered a decision in the Union case that turned on the evidence and was not a precedent on substantive issues about the appropriate level of equity thickness, intervenor arguments, in effect, seek to sidestep the decision by treating the evidence in the Union proceeding as if it creates a precedent for the purposes of consideration of Enbridge's equity thickness in this case.

71. Fourth, as addressed in Argument in Chief, because the outcome of the Union case was so fundamentally tied to the Board's concerns about the evidence before it in the particular case, that outcome does not provide a useful point of reference for what the Board should consider to be an appropriate equity thickness for Enbridge, especially given the very different evidence before the Board in this case.[107] If there had been further evidence before the Board in the Union case in some or all of the four areas noted by the Board, the Board's decision regarding the appropriate equity thickness for Union may well have been different. As a result, the appropriate equity thickness for Union based on an evidentiary record that the Board would consider to be full and sufficient is not known at this time. This seriously undermines the value of Union's current level of equity thickness as a point of reference, or comparator, for the assessment of Enbridge's equity thickness on the evidence now before the Board.

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[105] Energy Probe Argument, pages 4-5.
[106] Argument in Chief, paragraph 46.
[107] Argument in Chief, paragraph 47.

72. The Board does not have to be concerned about the fact that Union cannot be relied upon as a comparator for the assessment of Enbridge's equity thickness, because there are other Ontario utilities that are appropriate comparators, namely, the electricity transmitters and distributors regulated by the Board. The equity thickness for those utilities has been established by the Board through previous sector-wide proceedings such as the consultative related to the Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors.[108]

G. ENBRIDGE'S COST OF DEBT (ISSUE E1)

73. As noted in Energy Probe's Argument, the Board-approved Settlement Agreement in this case sets out the agreed-upon forecast of Enbridge's 2013 cost rates for long, medium and short term debt and preference shares. There is also agreement on Enbridge's cost of debt for 2013 based on a 36% equity ratio. The open issue relates to Enbridge's mix of long, medium and short term debt and preference shares, and the resulting cost of debt, in the event that its capital structure is changed to 42% equity, or some other level.[109]

74. For the scenario where Enbridge's equity ratio is increased to 42%, the Company set out its proposed mix of long, medium and short term debt and preference shares, and the resulting cost of debt, in Part 1 of Appendix A to the revised Settlement Agreement.[110]

75. The only party to make submissions on this issue was Energy Probe. Essentially, Energy Probe argues that if Enbridge's equity ratio is increased, then the Company's level of short term debt should be equivalent to that of electricity distributors. This would result in a deemed short-term debt component of rate base being set at 4%.[111]

76. Enbridge disputes that Energy Probe's suggested approach is appropriate. The Company does not operate with "deemed" levels of short and long term debt. The proposal that Enbridge has made in the Settlement Agreement represents a reasonable re-adjustment of

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[108] Exhibit E2-1-2, paragraph 29.
[109] Energy Probe Argument, at page 13, and Revised Settlement Agreement (Exhibit N1-1-1, Issue E1 and Appendix A.
[110] Exhibit N1, Tab 1, Schedule 1, Appendix A, Part 1, page 9 of 9.
[111] Energy Probe Argument, at pages 14 to 15.

existing and planned debt, debt issuances and preference shares to accommodate the increase in equity ratio to 42%.

77. In the event that the Board were to approve an equity ratio different from 36% or 42%, then (as stated in response to an interrogatory[112]) Enbridge would have to evaluate alternatives for its mix of short, medium and long term debt and preference shares to best accommodate the approved change in equity ratio. In that circumstance, Enbridge requests that it be permitted to prepare a proposal to be shared with stakeholders and then presented to the Board for approval or determination.

I. CONCLUSION

78. For the reasons given in Argument in Chief, and in this Reply Argument, the evidence in this proceeding establishes that Enbridge's current 36% common equity level does not meet the Fair Return Standard.

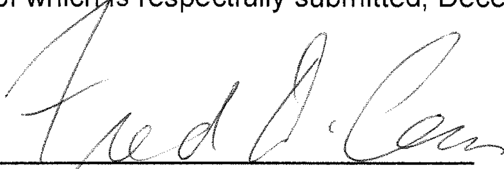
79. Concentric's analysis produces a recommended equity thickness for Enbridge in the range of 40% to 45%; Concentric's expert opinion is that Enbridge's proposed equity ratio of 42% per cent would bring Enbridge in closer alignment with its industry peers and support the maintenance of an A- credit rating.[113]

80. 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

[112] Exhibit I-E1-20.3 (updated on September 11, 2012).
[113] Exhibit E2-2-1, page 3.

of Appendix A to the revised Settlement Agreement[114] is appropriate and should be approved.

All of which is respectfully submitted, December 17, 2012.



Fred D. Cass
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[114] Exhibit N1, Tab 1, Schedule 1, Appendix A, Part 1, page 9 of 9.