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March 31, 2014

VIA RESS, EMAIL and COURIER

Ms. Kirsten Walli
Ontario Energy Board
2300 Yonge Street
Suite 2700
Toronto, Ontario
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**Re: EB-2012-0459 - Enbridge Gas Distribution Inc. ("Enbridge")
2014 – 2018 Rate Application
Argument-In-Chief**

In accordance with the Ontario Energy Board's (the "Board") letter dated March 26, 2014, attached please find the Argument-In-Chief of Enbridge for the above noted proceeding.

This submission was filed through the Board's RESS and is available on the Company's website at www.enbridgegas.com/ratecase.

Yours truly,

(Original Signed)

Bonnie Jean Adams
Regulatory Coordinator

cc: Mr. F. Cass, Aird & Berlis
EB-2012-0459 Intervenors

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*,
S.O. 1998, c. 15, Sched. B, as amended;

AND IN THE MATTER OF an Application by Enbridge Gas
Distribution Inc. for an order or orders approving or fixing
rates for the sale, distribution, transmission and storage of
gas commencing January 1, 2014.

**ARGUMENT IN CHIEF
OF ENBRIDGE GAS DISTRIBUTION INC.**

March 31, 2014

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ARGUMENT IN CHIEF OF ENBRIDGE GAS DISTRIBUTION INC.

Introduction

On July 3, 2013, Enbridge Gas Distribution Inc. (Enbridge) filed an application seeking approval of an Incentive Regulation (IR) methodology for the purposes of setting rates over a five year period beginning on January 1, 2014. Enbridge's evidence in support of the application describes its proposal for a Customized IR plan under which allowed distribution revenue amounts (Allowed Revenues) will be established for the years 2014 to 2018.

Pursuant to Procedural Orders issued by the Board, the process for consideration of Enbridge's application has included responses to written interrogatories, a Technical Conference and an oral hearing that began on February 20, 2014 and concluded on March 25, 2014. The Board established a schedule for written argument that provides for Argument in Chief to be submitted by March 31, 2014; this is Enbridge's Argument in Chief submitted in accordance with the Board's schedule.

The examinations of witnesses during the oral hearing of the application did not touch on all aspects of the case before the Board. In this Argument in Chief, Enbridge will focus on the areas of the case that received attention during the oral hearing and it will not attempt to anticipate issues or positions in other areas.

Enbridge's Argument in Chief starts with a description of the proposed Customized IR plan and ends with the conclusion that the evidence in this case strongly supports approval of the plan by the Board. Along the path to the conclusion that the plan should be approved by the Board, the argument will address the following points regarding Enbridge's proposal and the components of the plan:

(1) the proposed Customized IR plan is designed to fit Enbridge's specific circumstances and is a logical evolution of Enbridge's previous IR plan;

(2) when assessed from a number of different perspectives, the Customized IR plan is the right plan for Enbridge's circumstances and it leads to a fair and balanced outcome for ratepayers and the shareholder;

(3) the capital cost forecasts and resulting Allowed Revenue amounts within the Customized IR plan take account of capital spending requirements driven by large projects and increased safety and integrity requirements in a manner where the associated costs are set at the lowest possible prudent level, and include embedded productivity savings while excluding uncertain but likely "variable costs";

(4) the Customized IR plan provides a fair return on existing rate base and the substantial capital investments that will have to be made over the term of the plan, by incorporating reasonable forecasts of such costs into Allowed Revenues;

(5) the O&M costs included within Allowed Revenues have been established through an approach that embeds productivity (as would be the case in many IR plans) and will represent a significant challenge to the Company;

(6) Enbridge's Site Restoration Costs (SRC) proposal will result in adoption of a conceptually preferable methodology, a substantial refund to customers and reduced rates over the term of the Customized IR plan;

(7) the Customized IR plan includes appropriate mechanisms and features to encourage investments in sustainable efficiency measures, share rewards between the utility and ratepayers for superior performance, and protect the utility and ratepayers from consequences of significant unexpected cost changes beyond the utility's control;

(8) most of the proposed deferral and variance accounts continue the long-standing approach of ensuring that neither ratepayers nor the Company benefit or are burdened by items that ought to be cost pass-throughs; other proposed accounts address several discrete items that cannot be forecast with appropriate certainty and accommodate the implementation of Board decisions from other proceedings;

(9) the volume forecasts and the cost allocation methodology used to set Enbridge's rates for 2014 are based on the approved methodologies applied in prior rate case filings, appropriately applied in this case; and

(10) the rate and bill impacts that result from the Customized IR plan are reasonable, with an average rate increase of 2.2% for residential customers over the 2014 to 2018 period, and an even lower average bill increase of 1.4% per year.

The overall outcome of the Customized IR plan is that Enbridge is able to meet its coming challenges and deliver significant benefits and value to customers at reasonable rates. The impacts on customers are further moderated by the rate and bill mitigation effect of the SRC proposal.

1. Enbridge's Proposal for a Customized IR Plan

Enbridge has proposed a Customized IR plan that is designed to meet the circumstances faced by Enbridge over the period from 2014-2018. The plan, if approved by the Board, would create a revenue cap and would decouple revenues from actual costs for a five year term. The design of the plan takes into account a number of sources of guidance for the creation of rate regulation models and is a logical evolution of Enbridge's previous IR plan.

In the course of developing an IR proposal for the period from 2014 to 2018, Customized IR plan, Enbridge evaluated the efficacy of continuing with the model in its previous IR plan, which was a revenue cap per customer model based on a formula that used an Inflation Index and an inflation coefficient (generally referred to as an "I Minus X" model). Enbridge determined that continuation of an I Minus X framework is not a workable solution in the circumstances that will prevail for Enbridge over the years from 2014 to 2018. Specifically, Enbridge concluded that an I Minus X framework will not accommodate all of the hurdles faced by Enbridge, including capital spending pressures related to safety and integrity issues, very large capital projects related to system supply and work and asset management, growing depreciation costs, and uncertainty about future capital spending requirements.¹

Accordingly, Enbridge developed a Customized IR plan to fit its particular circumstances, while having regard to a number of sources of guidance, including the following:

- (i) the statutory objectives set out in section 2 of the *Ontario Energy Board Act, 1998*,² that guide the Board in carrying out its responsibilities in relation to gas;³

¹ Ex. A2-1-1, p. 3, para. 10.

² S.O. 1998, chapter 15, Schedule B.

³ Ex. A2-1-1, pp. 9-10, paras. 21-22.

- (ii) the criteria for a multi-year IR plan, or “gas rate regulation framework”, laid down in the Natural Gas Forum report⁴ by the Board;⁵
- (iii) the Board’s Renewed Regulatory Framework for Electricity Distributors (RRFE) report⁶ and, particularly, the parts of that report that discuss the Custom IR approach;⁷ and
- (iv) the “building blocks” ratemaking model that has been used in the United Kingdom and Australia.⁸

Enbridge submits that its proposed Customized IR plan appropriately takes account of all of these sources of guidance, while at the same time giving due consideration to Enbridge’s particular circumstances and business needs, as well as the interests of Enbridge’s customers.

Enbridge’s proposed Customized IR plan fixes Allowed Revenue for 2014 to 2018 based on forecast costs, inclusive of productivity savings, for each year.⁹ The Allowed Revenue for each year of the plan operates as a revenue cap¹⁰ and, upon Board approval of Allowed Revenues, the outcome is a decoupling of revenues from actual costs for the five year term of the plan.¹¹ As stated in Enbridge’s pre-filed evidence,

Just as with an I-X price or revenue setting regime, EGD’s model is designed such that future actual costs have no regard to the pre-determined revenue cap. Also, just as with an I-X or revenue setting regime, there are no adjustments for cost elements throughout the plan term.¹²

The proposed plan includes an annual rate adjustment process for 2015 to 2018, to update volumes and pass through cost items (gas costs and amounts determined in

⁴ *Natural Gas Regulation in Ontario: A Renewed Policy Framework*, Report on the Ontario Energy Board Natural Gas Forum, March 30, 2005, at pp. 2-3.

⁵ Ex. A2-1-1, page 9, paragraph 20.

⁶ *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach*, October 18, 2012.

⁷ Ex. A2-1-1, pp. 10-11, paras. 23-24.

⁸ Ex. A2-1-1, p. 14, para. 37 and Ex. A2-10-1.

⁹ Ex. A2-1-1, p. 3, para. 8.

¹⁰ 4Tr.53.

¹¹ 1Tr.13-14.

¹² Exhibit A2-1-2, p. 12, para. 42.

other proceedings), and it also includes appropriate protections for ratepayers and Enbridge, such as an Earnings Sharing Mechanism (ESM), a Z Factor mechanism and an Off-Ramp.

Enbridge's plan takes account of all of the considerations discussed above and it does so in a manner that represents a logical evolution from the previous IR plan. The following table summarizes how the Customized IR plan has evolved from Enbridge's 1st generation IR plan.

	1 st Generation Plan	2 nd Generation Plan	Rationale for Change in 2 nd Generation IR Plan
IR Cap model	Revenue Cap per Customer	Revenue Cap	Minor change: forecast costs for each year of the 2 nd Generation IR term are presented for approval. The impact of customer growth is accounted for within approved Allowed Revenue and there is no need for a "per customer" model.
Adjustment Mechanism	Annual Adjustment to Revenue Requirement based on formula that takes inflation and productivity into account.	Annual Adjustment to Allowed Revenue based on cost forecasts for each year of the IR term (which forecasts take account of inflation and productivity).	Change: Enbridge's spending requirements and business needs cannot be accommodated within a typical I Minus X mechanism.
Items Determined through IR Application	Revenue per Customer for the first year of the IR term, as well as the adjustment formula for future years. Certain cost items (see below) subject to annual updates as part of Revenue Requirement for subsequent years.	Allowed Revenue for each year of the IR term. Certain items (see below) subject to annual update as part of Allowed Revenue for subsequent years.	Change: The 2 nd Generation IR plan incorporates inflation and productivity within annual Allowed Revenue amounts, which allows for the Allowed Revenue for each year of the IR term to be set at the outset of the IR term.
Rates for 1 st Year of IR term	Final rates for the first year of the IR term, applying forecast volumes for that year.	Final rates for the first year of the IR term, applying forecast volumes for that year.	No change.
Cost Items Subject to Annual Update	Annual Cost Updates (flow-throughs) for gas costs, power generation projects and items approved through other proceedings (DSM, customer care), to be included within the annual Revenue Requirements (replacing the previous year amounts for the same items).	Annual Cost Updates (flow-throughs) for gas costs and items approved through other proceedings (DSM, customer care, pension/OPEBs), to be included within the annual Allowed Revenue amounts (replacing the previous year amounts for the same items).	Minor change: in addition to the items previously subject to update, forecast pension/OPEB costs updated each year within the Allowed Revenue amount.

	1 st Generation Plan	2 nd Generation Plan	Rationale for Change in 2 nd Generation IR Plan
Annual Rate-Setting Process	In advance of each year, Enbridge provided forecasts of customer numbers and inflation which were used to set an updated Revenue Requirement. Enbridge also provided forecasts of volumes and gas costs and the updated volumes information was applied to the updated Revenue Requirement for that year, to derive final rates.	In advance of each year, Enbridge will provide updated forecasts of volumes (using updated customer forecasts and applying the existing methodologies for HDDs, average use and large volume forecasts) and gas costs. The updated data will be applied to the approved Allowed Revenue for each year to derive final rates for that year.	Minor change to the annual process: while the forecast volumes, pass-through items and rates will be updated each year, the annual rate-setting process will no longer involve formulaic adjustments to the overall Revenue Requirement.
Earnings Sharing	To share earnings more than 100 basis points above Allowed ROE between ratepayers and the Company.	To share earnings more than 100 basis points above Allowed ROE between ratepayers and the Company.	No change.
Z Factor	To protect against unexpected costs or savings outside of management control that have a revenue requirement impact of more than \$1.5 million.	To protect against unexpected costs or savings outside of management control that have a revenue requirement impact of more than \$1.5 million.	Minor change: proposed improvements to the wording of the Z-Factor criteria.
Off-Ramp	Review of IR Plan if there is a variance from Allowed ROE of 300 basis points or more in either direction.	Review of IR Plan if there is a variance from Allowed ROE of 300 basis points or more in either direction.	No change.
Performance Measurement	Regular reporting through ESM proceedings and RRR filings.	Enbridge will track productivity initiatives and report annually. Enbridge will also track operational performance throughout, and report on performance at the end of the IR term. The Sustainable Efficiency Incentive Mechanism (SEIM) will provide an incentive for sustainable productivity.	Change: The enhanced tracking and reporting of operational performance, and the new tracking and reporting on productivity initiatives will enhance the Board's and stakeholders' understanding of the Company's performance under IR. The SEIM will provide an incentive for further lasting efficiency savings.
Term of Plan	Five Years	Five Years	No change.
Rebasing Requirements	File cost of service information for the first rate proceeding at the end of the IR term.	File cost of service information for the first rate proceeding at the end of the IR term.	No change.

The annual rate adjustment process, the Z Factor, the Earnings Sharing Mechanism (ESM) and the SEIM are discussed in further detail in section 8 of this argument.

2. Customized IR is the Right Plan for Enbridge's Circumstances

The Board's RRFE report indicates that the Custom IR rate-setting method for electricity distributors is intended to be customized to fit the specific applicant's circumstances. Enbridge has been able to customize a proposed IR model that, when assessed from many different perspectives, can be seen to be the right plan for Enbridge's circumstances. The proposed plan meets the Board's objectives, establishes incentives for sustainable efficiencies, accommodates capital spending, meets Enbridge's other costs challenges, advances the evolution of IR in Ontario, accommodates Enbridge's Site Restoration Costs proposal, overcomes problems associated with an I Minus X model and leads to a fair and balanced outcome for ratepayers and Enbridge's shareholder.

Enbridge submits that there is no principled or logical basis for an expectation that, over a five year term, Enbridge should live with a particular form of IR, such as an I Minus X model, without clearly showing that such a model will be able to satisfactorily manage Enbridge's circumstances. The Board has recognized in the RRFE report that the Custom IR rate-setting method for electricity distributors is intended to be customized to fit the specific applicant's circumstances.¹³ Enbridge submits that it is equally the case for a natural gas distributor that, rather than attempting to "force-fit" a particular model without regard to the circumstances of the utility, the Board can and should consider what model is best-suited to "the specific applicant's circumstances".

Enbridge submits that the proposed Customized IR plan is the right plan for Enbridge's circumstances and that this emerges clearly when the plan is viewed from a number of

¹³ RRFE report, *supra*, at pp. 18-19.

different perspectives. Said a different way, Enbridge submits that a typical I Minus X plan is the wrong plan for Enbridge's circumstances, and there has been no evidence adduced in this proceeding that contradicts this assessment. The many reasons why the Customized IR plan is the right plan for Enbridge's circumstances are addressed under the sub-headings that follow.

(i) Meets Board Objectives

As stated above, the Natural Gas Forum report sets out criteria for a multi-year IR plan, or "gas rate regulation framework". These criteria are as follows:

- (a) establish incentives for sustainable efficiency improvements that benefit both customers and shareholders;
- (b) ensure appropriate quality of service for customers; and
- (c) create an environment that is conducive to investment, to the benefit of both customers and shareholders.¹⁴

In his evidence, Dr. Kaufmann confirmed that these are the criteria that he applied in his assessment and review of Enbridge's Customized IR plan.¹⁵

Enbridge's Customized IR plan has been specifically designed with the three Board objectives in mind¹⁶ and it meets all three objectives.¹⁷ The proposed plan includes an explicit incentive, the SEIM, for sustainable efficiency improvements that benefit both customers and the shareholder.¹⁸ The plan ensures appropriate quality of service, in that it includes a Performance Measurement Framework and one of the two central elements of this Framework is a Performance Metrics Benchmarking Report.¹⁹ The

¹⁴ *Natural Gas Regulation in Ontario: A Renewed Policy Framework*, *supra*, at pp. 2-3.

¹⁵ 4Tr.129-130; *Enbridge Gas Distribution's Customized Incentive Regulation Proposal: Assessment and Recommendations*, Pacific Economics Group Research, LLC, Ex. L-2, pp. 12 and 27.

¹⁶ Exhibit A2-1-1, p. 9, para. 21.

¹⁷ Exhibit A2-1-1, p. 38.

¹⁸ More generally as to the efficiency incentives included in the Customized IR plan, see Exhibit A2-1-2, pp. 11-15.

¹⁹ Exhibit A2-11-2.

plan has been designed to accommodate Enbridge's capital spending needs, with built-in productivity and efficiency expectations, and, accordingly, it creates an environment that is conducive to investment, to the benefit of both customers and the shareholder.

It is noteworthy that the Customized IR plan has also been designed to meet important objectives that Enbridge has set for its own operations, such as the following:

- (a) a continued commitment to safety, including the safety of customers, the public and employees;
- (b) a focus on improving the customer experience across all interactions; and
- (c) improving productivity in all of Enbridge's operations.²⁰

(ii) Establishes Incentives for Sustainable Efficiencies

Enbridge's Customized IR plan is based on a multi-faceted approach to productivity improvements. First, Enbridge developed its spending forecasts in a manner specifically aimed at ensuring that productivity improvements are embedded in the forecasts themselves.²¹ Second, Enbridge has committed to the Performance Measurement Framework under which, in addition to the Performance Metrics Benchmarking Report mentioned above, Enbridge proposes to track and report on productivity initiatives by means of an annual Productivity Initiatives Report that will be filed as part of each ESM proceeding during the term of the plan.²² Third, Enbridge has proposed a Sustainable Efficiency Incentive Mechanism (SEIM) to provide an incentive for efficiency improvements that will be sustainable beyond the term of the Customized IR plan.

²⁰ Exhibit A2-1-1, p. 11, para. 26.

²¹ See, for example, Exhibit A2-1-1, pp. 11-12, paras. 28-29; Exhibit A2-1-1, pp. 14-25 and Exhibit A2-1-2.

²² Exhibit A2-11-2, pp. 3-5, paras. 7-13.

It is common to both I Minus X plans and the Customized IR plan that the decoupling of revenues from actual costs creates incentives for cost reductions. The Customized IR plan takes this further, however, and establishes an incentive mechanism, the SEIM, that singles out sustainable efficiencies in preference to short term cost-cutting.

The evidence of Pacific Economics Group Research (PEG) recognizes that a “critical issue” for I Minus X plans is the potential for “cost deferments”²³ PEG carried out an assessment of the I Minus X plans that were in effect for Enbridge and Union Gas Limited (Union) for the period from 2008 to 2012. In the report that resulted from the assessment of the plans, PEG said that it was important to ensure that “the incentives created by an IR plan are not undermined by what occurs when the plan expires”.²⁴ PEG went on to say that,

This would in fact occur if what appeared to be cost “reductions” under an IR plan suddenly re-appear in a base year application and are then reflected in the rates established for that year.

The assessment report refers to mechanisms that may be useful for addressing the “cost deferment issue” and the example given of such a mechanism is an efficiency carry-over mechanism.²⁵ In his oral testimony, Dr. Kaufmann expressed a preference for the Australian approach to Efficiency Carryover Mechanisms,²⁶ yet he confirmed that the Australian approach does not single out sustainable efficiencies in preference to short term cost-cutting.²⁷

In contrast, the SEIM has been specifically designed to single out sustainable efficiencies and, in this way, to meet squarely the Board’s objective for IR of establishing incentives for sustainable efficiencies. And, indeed, Dr. Kaufmann certainly

²³ *Assessment of Union Gas Ltd. and Enbridge Gas Distribution Inc. Incentive Regulation Plans*, Pacific Economics Group Research, LLC, Ex. L-1, p. 124.

²⁴ *Ibid.*

²⁵ Assessment report, Ex. L-1, p. 125.

²⁶ 3Tr.65.

²⁷ 4Tr.137-138.

agreed that the incentives within Incentive Regulation should be aimed at sustainable efficiencies, as opposed to short term cost-cutting.²⁸

While it cannot be said that the SEIM is a perfect solution to the issue of creating an incentive for efficiencies that are truly sustainable, the SEIM represents a positive and meaningful effort to improve upon other IR plans that reward cost-cutting during the term of a plan but do not put a specific focus on sustainable efficiencies. No-one involved in this case has suggested a better way to focus specifically on sustainable efficiencies than Enbridge's SEIM.

(iii) Accommodates Capital Spending

Dr. Kaufmann confirmed two important propositions in relation to capital spending by natural gas utilities. First, he confirmed that renewed attention to codes and standards for gas utilities in North America has, over a number of years has become increasingly important.²⁹ Second, he confirmed that, as a result of these new attitudes to codes and standards, it would be important for any gas utility to be sure that it operates under a regulatory model that will accommodate its appropriate spending on safety and reliability.³⁰

The importance of a regulatory model that accommodates safety and reliability spending can be seen from the evidence about the proceeding in Massachusetts in which Dr. Kaufmann was a witness for a gas distributor, Bay State Gas. Dr. Kaufmann's oral testimony makes clear that the outcome of the proceeding was that the regulator terminated the distributor's PBR plan.³¹ Dr. Kaufmann's testimony also indicates that it was his client's position in the proceeding that the PBR plan, which was

²⁸ 4Tr.137.

²⁹ 4Tr.146.

³⁰ 4Tr.146.

³¹ 4Tr.146.

based on a price cap index, had failed to compensate for the timely recovery of incremental capital investment made for safety and reliability purposes.³²

The Customized IR plan of course has been designed to accommodate Enbridge's safety and reliability spending needs over a five year term. It provides Enbridge with the ability to address "must-do" work to maintain the safety and reliability of its distribution system.³³ It also takes account of Enbridge's other capital spending requirements during the term of the plan.

(iv) Meets Enbridge's Cost Challenges Over a Five Year Term

Enbridge explained in its pre-filed evidence how the Customized IR plan has been designed to allow Enbridge to deal with cost pressures over the five year term of the plan, while, at the same time, stretching Enbridge to find productivity.³⁴ This evidence highlighted depreciation expense as one of the cost pressures faced by Enbridge that cannot be accommodated in an I Minus X model. As stated in the pre-filed evidence:

Another cost pressure relates to the fact that the Company's depreciation expense is forecast to grow, on average, almost 6% annually over the coming years. This is a function of past capital investments and increasing capital expenditures. Depreciation represents almost a third of the estimated Allowed Revenue, but it is growing about twice as fast as the remaining elements.³⁵

The pre-filed evidence went on to explain that Enbridge's depreciation expense cannot be accommodated in an I Minus X ratemaking plan.³⁶ The evidence summarized this point in the following manner:

Assuming that most other cost elements are growing at close to inflation, revenue necessarily would need to grow at a rate greater than inflation for the Company to earn the Allowed Return. As explained at Exhibit A2, Tab 1, Schedule 3, the cost pressures from depreciation expense are not

³² 4Tr.146.

³³ Exhibit A2-1-1, p. 38, para. 125.

³⁴ Exhibit A2-1-1, pp. 3-4, paras. 10-11; and pp. 14-25.

³⁵ Exhibit A2-1-1, p. 23, para. 67. See also Exhibit A2-1-3, pp. 17-18, paras. 33-35.

³⁶ Exhibit A2-1-3, pp. 17-18, paras. 33-35.

accommodated within a traditional I-X I model, and are a main contributor to Enbridge's decision to proceed with this Customized IR model.³⁷

In his oral evidence, Mr. Culbert explained why the impact of depreciation during the term of the proposed plan is a much more significant concern than it was under the previous IR plan. Mr. Culbert testified that,

There have been changes in circumstances versus our first gen IR. We are all aware that our average cost of debt that was resident in existing rates going into our first gen IR was at a fairly high average because we had some historical debt that was at high rates.

In that term, we were aware that the forecast of interest rates going forward was going to provide some cushion as offsets to things like depreciation expense increases that aren't matched by inflation.

So we are aware of various levers.

Going forward, we're of the opinion that our debt costs have been averaged down to such a degree we're not going to see interest reductions in the same vein that we did during the first IR term, but yet our depreciation expense increases are increasing dramatically, and an I-X solution just does not cover those things off.³⁸

The incompatibility of an I Minus X plan with Enbridge's increasing depreciation expense was addressed in the pre-filed evidence, confirmed by Mr. Culbert in oral testimony and reinforced in later testimony³⁹ and no party to this proceeding has led evidence to the contrary.

(v) Advances the Evolution of IR In Line with the RRFE Report and the Need for Customized Models

A view expressed by a number of witnesses in this proceeding, and discussed during the testimony of the joint panel of experts, is that incentive regulation has been evolving, both in Ontario and in jurisdictions outside Ontario. During his testimony on the joint witness panel, Mr. Coyne made the following comments in this regard:

³⁷ *Ibid.*

³⁸ 2Tr.25.

³⁹ 2Tr.125.

...if you look at how the soup is made, you fall less in love with an I-X as giving you comfort that you would like to have that the costs on a going-forward basis are well matched to the utility at hand ... I take greater stock ... by being able to look at what company-specific cost projects are, and being able to evaluate those as being appropriate for that company

... But what we've seen is for those regulators that have experimented with the I-X, they found them to be imperfect solutions, for the reasons that I have described. That's why we've seen hybrid models that have been adopted ... or some other approach that still builds in incentives, but it doesn't rely on the very broad hammer which is an I-X. So I would say that incentive regulation, in my belief, has grown more sophisticated since its early adaptations.⁴⁰

Dr. Kaufmann expressed agreement with Mr. Coyne's comments about the evolution of incentive regulation, in the following testimony:

I do agree, in some respects, with Mr. Coyne. .. it's clear that there has been a greater diversity of approaches to alternative regulation that have evolved over the last 10 or 12 years, and most of those have dealt with appending different types of mechanisms for recovering capital costs for companies that ... would not be able to live under an I-X plan. And that's also something that ... the Board has been very attentive to.⁴¹

One of the best available indicators of the evolution of the Board's approach to incentive regulation is the RRFE report. As stated by Mr. Lister,

It is not just that it informed our thinking, the RRFE, but it shows an evolution in the thinking of the Board with respect to incentive regulation. And in fact, that is how they present the document. So from our perspective, it is a very relevant document.⁴²

While the RRFE Report does not apply directly to gas utilities like Enbridge, the Customized IR plan lines up extremely well with the approach to IR laid out by the OEB in the RRFE and, in particular, with the Custom IR approach. The following are some of the many ways in which the Customized IR plan lines up with the Board's approach to IR laid out in the RRFE:

⁴⁰ 4Tr.87-89.

⁴¹ 4Tr.89-90.

⁴² 2Tr.14-15.

- (a) the Customized IR plan is designed to fit the specific circumstances of Enbridge;⁴³
- (b) the Customized IR plan is appropriate for Enbridge due to significantly large multi-year or highly variable capital spending needs;⁴⁴
- (c) while the Customized IR plan is not based on an I Minus X approach, Custom IR under the RRFE does not have to be based on I minus X;⁴⁵
- (d) the Customized IR plan is based on evidence of cost and revenue forecasts over a five year horizon, as well as detailed infrastructure investment plans over that same time frame;⁴⁶ and
- (e) Enbridge is committed to the Customized IR plan for the duration of the five year term, subject to an Off-Ramp such as that contemplated by the RRFE report.⁴⁷

Enbridge submits that the design of the Customized IR plan reflects the evolution of incentive regulation rate-making methodologies towards the development and application of models that fit the circumstances of particular utilities. The implication of intervenor cross-examinations during this proceeding was that Enbridge should be expected to continue to live with an I Minus X model, without regard to whether the model is best-suited to Enbridge's circumstances. Enbridge submits that the static view of incentive regulation methodology suggested by intervenors is out of step with the record of evidence in this proceeding about the evolution of incentive regulation plans in Ontario and elsewhere.

(vi) Accommodates Enbridge's SRC Proposal

Enbridge has made a proposal with respect to net salvage percentages or Site Restoration Costs (SRC)⁴⁸ that stands on its own and is not specifically tied to a

⁴³ See the RRFE report, at pp. 18-19.

⁴⁴ See the RRFE report, at p. 19.

⁴⁵ 4Tr.135.

⁴⁶ See the RRFE report, at p. 19.

⁴⁷ See the RRFE report, at p. 19.

⁴⁸ See Section 7, "Enbridge's Site Restoration Costs Proposal", below.

particular rate regulation model.⁴⁹ All the same, though, the Customized IR plan, allows Enbridge to model the implications of the SRC proposal, including cost of capital and depreciation changes and tax changes, relative to forecasts of rate base within Allowed Revenues, much like Enbridge would be able to model these implications under five years of cost of service rate regulation.⁵⁰ An I Minus X model, however, would not include forecasts of rate base to use in modelling the cost of capital, depreciation and tax implications of the SRC proposal.

This point was explained by Mr. Culbert in the following oral testimony:

...the implications of [the SRC proposal], as you've heard me speak to, and cost of capital and depreciation changes and tax changes, are all currently as constituted relative to our forecasts of rate base resident within our allowed revenues.

...So to the extent that we were coming forward with ... I'll use the term an "I-X solution" ... the impacts relative to these projections would not be the same.

...If we weren't going to go the route of our allowed revenue calculations inclusive of rate-based forecasts, then I really can't tell you what the impact of our proposal in terms of depreciation rates would be for ratemaking purposes.

I could tell you what the impact is in our actuals on an after-the-fact basis, our actual rate base, but I can't tell you what it would be for ratemaking purposes because you wouldn't be setting rates based off of rate base projections and cost of capital associated with depreciation expense and tax implications.⁵¹

In short, the rate base projections that form part of Enbridge's Customized IR plan can be used for the purposes of quantifying, presenting and explaining the cost of capital, depreciation and tax implications of the SRC proposal. Thus, the Customized IR plan accommodates the SRC proposal in a way that facilitates a transparent and detailed

⁴⁹ 2Tr.63-64; 9Tr.151; 9Tr.195-6.

⁵⁰ 9Tr.151-152.

⁵¹ 9Tr.152-153.

understanding of the effects of the SRC proposal looking ahead through the five years of the term of the IR plan.

(vii) Overcomes the Problems Associated with “I Minus X”

Enbridge’s previous IR model relied on an I Minus X escalator, supplemented by a revenue cap per customer calculator and Y Factors for specific incremental projects not subject to the revenue escalator.⁵² Add-ons” to a basic I Minus X model were designed to take account of the particular needs of Enbridge’s business at the time. Over the coming five-year period, Enbridge’s business needs present much greater challenges for its rate regulation framework, including, as discussed above, capital spending pressures related to safety and integrity issues, very large capital projects such as the GTA Project and WAMS, growing depreciation costs, and increased uncertainty about future capital spending requirements.

As stated by Mr. Coyne during cross-examination at the hearing,

We tested the forecast revenue requirement for Enbridge over the five-year period against that I-X, and as we well know, they don’t match.

And the reason they don’t match is that Enbridge has been one of the fastest growing utilities in this group. They have also spent faster, by way of capital investment over the historic period vis-a-vis this group, and they continue to do so over the forecast period.

And that is why there is a mismatch between what I-x can do, what we measure in our TFP analysis, and the revenue requirement projected for Enbridge.⁵³

The evidence is that the escalation factor under an I Minus X methodology that would be required to meet Enbridge’s challenges over the next five years would be well in excess of traditional values for “I” and “X”.⁵⁴ Further, the evidence is that the introduction of more “add-ons” to an I Minus X model in an attempt to accommodate

⁵² Ex. A2-1-3, p. 3, para. 8.

⁵³ 4Tr.28-29.

⁵⁴ 2Tr.20 and 27-28; Ex. A2-1-3, p. 18, para. 37.

these challenges would result in further complexity, an unwieldy IR framework and a patchwork approach to incentive regulation.⁵⁵ Just as the RRFE report recognizes that Custom IR is the appropriate rate regulation framework for electricity distributors with significantly large multi-year or highly variable investment commitments in excess of historical levels, the Customized IR plan is the appropriate framework to meet Enbridge's challenges over the next five years. The Customized IR plan includes a multi-faceted productivity challenge, appropriate incentives, a mechanism for ratepayers to share in additional savings beyond productivity built into the forecasts and other features to mitigate any unintended consequences.⁵⁶

(viii) Produces a Fair and Balanced Outcome for Ratepayers and the Shareholder

Over the five years of the Customized IR plan, the average annual rate increase for residential customers is approximately 2.2%, taking into account the impact of the GTA Project. Without the GTA Project, this average annual increase would be about 1.6%. Over the five year term, bills for residential customers will increase by about \$59, or an average increase of 1.4%, taking into account the SRC rate rider and the GTA Project.⁵⁷ The GTA Project of course delivers a number of benefits and is expected to result in substantial gas cost savings for customers.⁵⁸

It can be seen, then, that the Customized IR plan enables Enbridge to meet important capital spending needs -- for purposes such as the GTA Project, WAMS and safety and integrity requirements -- and to achieve a fair return on substantial capital investments, with reasonable rate impacts. Further, the implementation of Enbridge's SRC proposal operates so as to reduce both rate and bill impacts.⁵⁹ The overall outcome is that Enbridge is able to deliver significant benefits and value to customers, including the

⁵⁵ 2Tr.32; Ex. A2-1-3, pp. 18-19, para. 37.

⁵⁶ Ex. A2-1-3, p. 19, para. 38.

⁵⁷ Ex. A2-1-1, p. 7, paras. 14-16 and pp. 39-40, paras. 130-131.

⁵⁸ Ex. A2-1-1, p. 8, para. 17.

⁵⁹ See Section 7, "Enbridge's Site Restoration Costs Proposal", below.

benefits of the GTA Project, at distribution rates that are reasonable and that are further moderated by the rate and bill mitigation effect of the SRC proposal. Enbridge submits that the Customized IR plan produces a fair and balanced outcome for ratepayers and for Enbridge's shareholder.

(ix) No Evidence Supporting an Alternative Model

It must be noted as well that no evidence has been filed by any party in support of an alternative model to the Customized IR plan and there is no evidentiary base upon which the Board could conclude that another model is more appropriate for Enbridge's circumstances than the proposed plan. At the outset of the proceeding, the Board expressly referred to the possibility of establishing an alternative ratemaking framework, but it noted that there would need to be an evidentiary base for such a result. This can be seen in the Board's Decision on Need for a Preliminary Issue issued on October 3, 2013, where it is stated that,

The Board has not heard any compelling case that it would be restricted from establishing an alternative framework, were it to find that it would be appropriate to do so, and provided that there was an evidentiary basis for it.⁶⁰

Subsequently, Section D, titled "Alternative Proposals", was included in the Issues List for this proceeding. The issues set out under the Alternative Proposals heading of the Issues List are as follows:

33. With respect to any alternative IR plan proposed for Enbridge, does that proposal meet the Board's objectives for incentive regulation for gas distributors and is it appropriate?

34. With respect to each of the components of any alternative IR proposal, are those components appropriate?⁶¹

No party has chosen to file evidence in support of any alternative proposal.⁶² Because no evidence has been filed in support of an alternative proposal, there has been no

⁶⁰ Decision on Need for a Preliminary Issue and Procedural Order No. 2, October 3, 2013, p. 3.

⁶¹ Decision on Issues List and Decision on Motion, November 5, 2013, Appendix "A", Issues List, p. 5.

opportunity to test any alternative proposal in accordance with Issues 33 and 34 in the Issues List. In the result, there is no evidentiary basis upon which the Board could establish an alternative ratemaking framework.

3. Enbridge's Capital Spending Needs

Enbridge's capital spending requirements for 2014 to 2018 were identified through a lengthy, rigorous process that identified the lowest possible prudent capital budget. The Core Capital spending requirements are driven by more stringent safety and integrity requirements and expectations being applied to an aging plant, as well as continued customer growth and ongoing business requirements. By assuming productivity savings and taking the risk of variable costs onto itself, Enbridge has been able to create a Core Capital budget that declines versus the rate of inflation while accommodating the Company's very real and growing capital spending requirements. There are further capital costs associated with the Board-approved GTA Project and with the WAMS project, which increase the Company's capital spending requirements above historic levels.

The capital budget for the term of the Customized IR plan is the combination of three elements: (i) the GTA Reinforcement Project, which has been the subject of a leave to construct approval; (ii) the needs of the Company to sustain operations, including customer additions, replacements and relocations; and (iii) the integrity management programs which the Company is required to undertake.

As the GTA Project was the subject of a Board-approved leave to construct application, and its costs are addressed by the proposed GTA Project Variance Account, these costs are not the focus of this section of the argument.

⁶² Dr. Kaufmann confirmed that he was not asked to prepare an alternative proposal or a counterproposal and that he has in fact not done so: 4Tr.126.

The balance or “Core Budget” relates to the capital costs that will be incurred from 2014 to 2018 to meet customer growth, the business needs of the Company and the integrity management programs that the Company has been mandated to undertake. Also associated with the “Core Capital” budget is the Work & Asset Management Solution (WAMS). For ease of reference, the following Table identifies the 2012 and 2013 Actuals and forecast 2014-2018 “Core Capital” budgets.

2012-2018 Core Capital (\$millions) Expenditure⁶³								
	2012 ⁶⁴ Actual	2013 Board Approved	2013 Actual	2014 Forecast	2015 Forecast	2016 Forecast	2017 ⁶⁵ Actual	2018 Actual
Core Capital	418.7	386.1	441.6	443.8	446.6	441.9	441.9	441.9
WAMS		0.5		36.3	25.7	8.1		
Subtotal	418.7	386.6	441.6	480.1	472.3	450.0	441.9	441.9
GTA/ Ottawa	19.1	63.3	76.2	202.2	359.7			
Total	437.8	449.9	517.8	682.3	832.0	450.0	441.9	441.9

The above Table clearly demonstrates several realities.

First, the rate of increase in the forecast Core Capital budget (excluding the GTA and Ottawa Reinforcements and WAMS) over the 5-year term of the IR Plan actually declines relative to inflation, using either 2013 Actuals or 2014 Forecast as the starting point.

Second, the 2013 Board-approved level of capital budget is clearly not reflective of the Company’s actual capital spending requirements for the past couple of years, or the anticipated requirements for the Customized IR term.⁶⁶

⁶³ Ex. B2-1-1, p.44, update to Table 2.

⁶⁴ Ex. I.B18.EGDI.Staff.56

⁶⁵ The Company is proposing to continue the 2016 forecast capital budget, excluding WAMS, for 2017 and 2018.

⁶⁶ 5Tr.113-114.

Third, the forecast Core Capital budget is virtually unchanged relative to the 2013 Actuals (\$441.6 million in 2013 versus \$441.9 million forecast for 2018).

Fourth, the increase in the Core Capital budget between 2012 Actuals and 2018 Forecast – a period of 7 years – is only 7.9%, an increase of about 1.1% per year.

Finally, it can be seen that when the costs of the GTA Project (along with Ottawa) and WAMS are included, the overall level of capital spending requirement in some years of the Customized IR plan is substantially different from prior years.

The fact that the Company has actually incurred Core Capital costs in 2013 of \$441 million is evidence of a demonstrable need for expenditures at this level. It should therefore not be surprising that there has been no evidence presented in this proceeding suggesting that the Company could safely and reliably operate with a lower core capital budget. Indeed, the only evidence filed and heard in this proceeding is that it will be a significant challenge for the Company to limit its capital expenditures to the forecast amounts given the business and regulatory pressures which exist.

The lack of any evidentiary challenge to the Company's capital budget, including WAMS, is also likely the result of the granularity and transparency of the budget setting process followed by the Company – a process fully documented in evidence, tested at the hearing, and highlighted below. The pre-filed evidence goes into great detail about the extraordinary steps undertaken by the Company to develop its budget for the 5-year term of the Customized IR plan.⁶⁷ The Capital Budget Overview panel (panel 2) included a member of Enbridge's executive management team, Jim Sanders, a senior professional engineer with responsibility for the Company's capital projects.⁶⁸ Mr. Sanders confirmed in his testimony that he had personal responsibility for ensuring that the capital budget was set at the lowest level possible, and explained that:

⁶⁷ As set out within Ex.B2-1-1, pp.17-31.

⁶⁸ It also included Lisa Lawler, another senior professional engineer with responsibility for the Company's integrity management activities.

When combining all the above requirements⁶⁹ it became clear early in the planning process that the next five years would not be typical. A thorough review would be necessary to ensure that the company developed an overall plan that would be at the lowest prudent capital requirement possible, which included immediate and sustained productivity.

The company can assure this Panel that each project was reviewed and assessed for the need in the company's efforts to arrive at the lowest cost prudent plan.⁷⁰

Enbridge's rigorous capital budget process is described below in more detail.

The evidence which supports the proposed capital budgets is both detailed and extensive. The pre-filed evidence includes descriptions about the need for, the cost and particulars of each of the Company's capital budget plans and programs.⁷¹ There simply is no evidence that any capital program or plan proposed by the Company is not required or that its forecast costs are excessive.

In addition, the managers of each of the Company's capital programs were produced and subjected to cross-examination. At the oral hearing, the Company produced six panels, with 25 witnesses to be cross-examined on the Company's capital budget requirements.⁷² These witnesses not only demonstrated the need for the various capital programs but also the challenges that the Company faces to operate within the constraints of the budgets as requested. The evidence and testimony clearly establish that Enbridge requires the requested capital budgets to operate its growing distribution system in a safe manner, consistent with regulatory requirements, over the Customized IR term. High-level details of the drivers of Enbridge's capital budgets are set out below.

⁶⁹ Including system integrity and reliability programs, major projects capital requirements, increased externally initiated relocation requirements, continued customer growth and other base capital requirements, including facilities, fleet and IT – all of which are noted by Mr. Sanders at 4Tr.172-173.

⁷⁰ 4Tr.173.

⁷¹ As seen in the B2 series of exhibits, which total 545 pages of narrative evidence. There are many more pages of related interrogatory responses.

⁷² Note that panel 7 (Storage, Facilities and Fleet) was produced, but no party had any questions for that panel.

Enbridge submits that the capital budget is not only reliable, it is more likely than not, inadequate and the Company faces a significant risk of having to overspend relative to these budgets, as it did in 2012 and 2013. In this regard, Mr. Sanders indicated in cross-examination that:

... [W]e have taken steps to include a stretch within our budget to not over-forecast. If anything, at this point in time I am highly uncomfortable that we have under-forecast our capital.

If you look at 2012 and 2013 again, you can see that that trend of moving up to about the \$440 million range has actually occurred. And in the number of the programs we have presented, those cost pressures are only going up, not going down.

So in fact, in getting out to 2016 and 2017 -- or, sorry, 2017 and 2018 again, and continuing to fix it at the 440 million range, really I think is a minimal risk of under-spending over the five-year term, notwithstanding your hypothetical on the GTA.⁷³

Ms. Squires confirmed under cross-examination that the Company is currently operating to the 2014 budget filed in this application.⁷⁴ There is, therefore, no room for a decrease. Indeed, at this level of capital spending, as noted by Mr. Sanders in testimony, it will take the Company three centuries to replace all of its assets,⁷⁵ despite the fact that a material percentage of the Company's assets are aging, with some being more than 60 years of age.⁷⁶ In other words, simply replacing worn out assets will be a budgetary growth driver in future.

In summary, the reasonableness and necessity of Enbridge's forecast capital budgets for 2014 to 2018 are demonstrated through, among other things, (i) the detailed evidence of the spending requirements across each of the 8 capital business areas⁷⁷; (ii) the rigorous process undertaken to establish the budgets and embed productivity

⁷³ 4Tr.196-197.

⁷⁴ 5Tr.50.

⁷⁵ 5Tr.68.

⁷⁶ 5Tr.129.

⁷⁷ As set out at Ex.B2, Tabs 2 to 9.

challenges within the budget amounts; and (iii) the fact that the “Core Capital” spending requirements are consistent with actual spending in recent years.

The Customized IR plan enables Enbridge to meet its important capital spending needs set out within its forecast capital budgets for purposes such as safety and integrity requirements, the GTA Project and WAMS. At the same time, ratepayers benefit from Enbridge’s smoothing of capital spending requirements, from the embedded productivity amounts and from the exclusion of variable costs from the capital spending amounts that will be reflected within Allowed Revenues.

(i) The Capital Budget Process

The evidence explains how and why the Company went through six detailed reviews and iterations of its capital budget.⁷⁸ This process was described by Mr. Sanders, during evidence in chief:

Enbridge capital requests in this proceeding represent the outcome of a rigorous examination of capital requirements over the 2014 to 2018 period. This process considered a number of factors, including the starting point of the 2013 Board-approved capital. These factors are provided in some detail in the company’s prefiled evidence, and include the areas already mentioned above, balanced with the overall impact to ratepayers.

The goal of the process was to arrive at the lowest possible capital requirement while prudently meeting the varied needs of our customers, ongoing operations, and the operating system’s safety and reliability requirements.⁷⁹

....

Over a period of several months the capital process completed six reviews to arrive at the final version included in this application.

The review process considered a number of criteria in an effort to reach reduced but viable -- reach a reduced but viable capital plan. These include the overall priority of the projects, the probability of the requirement, reduced pace for long-term programs, considerations for

⁷⁸ This is described in Ex.B2-1-1, and in many interrogatory responses.

⁷⁹ 4Tr.173.

alternatives to the projects as proposed, including further study before proceeding, and finally, the economic implications of the projects, including the potential for enhanced productivity.

Over these review cycles, approximately \$180 million of capital costs were removed from the projects submitted. The results of the review process provided in the evidence -- are provided in the evidence of this -- included in this application.⁸⁰

When this topic was pursued in cross-examination, Mr. Sanders provided further detail about the rigour of the capital budget process:

Mr. Mandyam and myself actually were charged with delivering the lowest possible prudent capital budget. We assembled a team of roughly a dozen people in that process. Those people included technical experts, legal experts, regulatory experts, financial experts.

In that team, we on the construction engineering and operations side, we had a team of people that had over a hundred years of direct experience in those areas.

That team went through, as you can see in the evidence, many reviews to critically assess the requirement to arrive at that lowest possible prudent capital budget.⁸¹

To achieve the objective of producing the lowest possible prudent budget, the Company removed variable costs totaling around \$165 million⁸² from the 2014 to 2016 budgets. Over the five year Customized IR term, Enbridge estimates that the excluded variable costs total around \$264 million.⁸³ These “variable” costs are costs that are dependent on outcomes from planned studies and other future activities, such that the amount of such costs cannot be forecast with certainty.⁸⁴ Importantly, as Mr. Sanders indicated in an exchange with the Panel Chair, Enbridge’s decision to remove variable costs from its budget is different from the approach that would be taken in the creation of a typical “cost of service” application.⁸⁵ The Company imposed this budget reduction despite

⁸⁰ 4Tr.173-174.

⁸¹ 5Tr.18.

⁸² Ex.I.B18.EGDI.STAFF.55.

⁸³ Ex.J1.7, pp.5-7.

⁸⁴ Ex.B2-1-1, para. 67.

⁸⁵ 5Tr.168.

knowing that a material portion of these costs will actually be incurred over the term of the Customized IR plan. Indeed, when asked about this under cross-examination, Mr. Sanders stated that he expects that more than \$100 million of these variable costs will be incurred.⁸⁶

The budgeting process involved the prioritization of the various programs, again in a concerted effort to develop a budget that reflects the costs of the programs which are priorities⁸⁷ and sufficiently developed to address the Company's immediate needs. After much effort, the Company has been successful smoothing its prioritized expenditures over the term of the IR Plan.⁸⁸ As described below, the smoothed budgets include embedded productivity. They also assist in smoothing Allowed Revenue amounts.⁸⁹

To further demonstrate its commitment to developing the lowest possible prudent capital budget, the Company is proposing to hold its capital budget at the 2016 level in 2017 and 2018, with the exception of two new variance accounts that relate to a small portion of the budgets.⁹⁰ As explained in evidence, this likely understates the actual level of required spending in the last two years of the Customized IR term. That is seen from the fact that Enbridge's Asset Plan forecasts higher spending in those years, and also in the fact that holding the budgets flat does not provide Enbridge with any coverage for inflationary increases in costs.⁹¹

(ii) Main Cost Drivers

There are several key factors that underlie Enbridge's proposed capital budgets on an overall basis, and within its 8 capital business areas, for 2014 to 2018. These include: (a) the evolution in requirements for the Company's system integrity and reliability

⁸⁶ 5Tr.57.

⁸⁷ 5Tr.62.

⁸⁸ 5Tr.56.

⁸⁹ 2Tr.74.

⁹⁰ These are described below, under the heading "Deferral and Variance Accounts".

⁹¹ Ex.B2-1-1, pp.39-41.

program; (b) ongoing customer growth; (c) third-party requirements; (d) the needs of the Company to sustain operations; and (e) the WAMS project.⁹²

(a) *the evolution in requirements for the Company's system integrity and reliability program*

The scope and scale of system integrity and reliability programs that Enbridge must undertake and include in its capital budgets for future years is significantly impacted by recent regulatory changes in Ontario. The new version of the Ontario pipeline regulations (clause 3.2 of CSA Z662-11) requires Enbridge to introduce and maintain a distribution system integrity management system for all of its operating assets. The significance of this change was described in testimony by Mr. Sanders as:

A fundamental technical regulatory shift that requires the Company to assess both potential failures for all operating assets, and to proactively mitigate before these failures occur.⁹³

...

The last time this type of regulatory change occurred was over a decade ago. The Ontario pipeline regulations introduced at that time required pipeline operators to proactively assess for potential failures of pipeline systems operating above 30 percent of the specified minimum yield strength and to mitigate these potential failures.

...

The 2002 regulations and the resulting integrity program covered less than 1 percent of the Company's operating assets. This application includes the capital requirements to meet the expectations of the 2012 regulations, and integrity management programs for 100 percent of the Company's operating assets.⁹⁴

The chronology and specifics of the regulatory changes are set out in the pre-filed evidence⁹⁵ and at Undertaking J5.11.⁹⁶ As noted in this undertaking response, the changes to the regulatory standards, which became effective November 1, 2012 with

⁹² The capital budgets are also impacted by the GTA Project, which has already been approved by the Board.

⁹³ 4Tr.170

⁹⁴ 4Tr.171.

⁹⁵ Ex.B2-1-1, pp.14-16 and Ex.B2-10-1, pp.56-62.

⁹⁶ Ex.J5.11.

the adoption of CSA Z662-11, included new mandatory language for all pipelines regardless of the Specified Minimum Yield Strength (SMYS) percentage of the pipeline.

As explained in the Asset Plan⁹⁷, this regulatory change requires significantly more effort by the Company than the historic approach and has required it to develop proactive and prudent programs for risk reduction. Assessing the current potential risk of all operating distribution assets requires first a determination of what the potential risk could be; for each type of asset there are a number of potential failures that occur with corresponding probabilities. In short, the fundamental shift involves moving from a reactive approach of responding to failures when they occur to a proactive approach of anticipating failures and mitigating them before they occur.

In response to the change to the regulation, as well as recent industry incidents such as the San Bruno (California) and Marshall (Michigan), the Company has updated its asset management approach. As confirmed by Ms. Lawler in cross-examination, Enbridge has taken guidance from the change in legislation, as well as industry trends and events, and has determined that it is important to proactively improve safety and reliability approaches, because these have not been as good as they should be.⁹⁸

The results of Enbridge's efforts to comply with the language of CSA Z662-11 clause 3.2 and the expectations of the TSSA are seen in the Asset Plan⁹⁹, and are explained within the System Integrity and Reliability capital budget evidence.¹⁰⁰

This includes several integrity management programs which involve the inspection and verification of the state of operating assets. While the costs to undertake these evaluation programs are included in the capital budget (for example, making necessary changes to a pipeline to introduce and allow inspection equipment to perform an in-line inspection (ILI) of a pipeline), the Company has not included in its capital budget any amount for the replacement of pipelines which become required given the findings of

⁹⁷ Ex.B2-10-1, pp.56-62.

⁹⁸ 5Tr.128.

⁹⁹ As explained in Exhibit B2-10-1, pp. 56-84.

¹⁰⁰ Ex.B-5.

the ILI Program¹⁰¹ and the Minimum Operating Pressure (MOP) program.¹⁰² Obviously if these programs determine that segments of pipelines are failing or about to fail, they must be replaced. These costs are real, yet do not reside in the as-filed capital budget.

Additional details about the actions which the Company has undertaken in response to the regulatory change are set out in the response to Undertaking J5.3.¹⁰³ This response confirms that over the first three years of the Customized IR plan, the incremental (increased) costs for programs that are impacted by the change in regulation and changes in industry practices resulting from recent incidents is around \$400 million.

(b) Ongoing customer growth

A significant driver of Enbridge's capital budgets over the coming years is the expectation of significant customer growth from 2014 to 2018. As set out in the evidence, the Company expects to add almost 195,000 new customers during the Customized IR term.¹⁰⁴ This entails substantial capital costs for customer connections¹⁰⁵, reinforcements¹⁰⁶ and business-as-usual activities.

Importantly, however, Enbridge is making strong commitments within its Customer Growth capital budget to limit the level of costs to be included within Allowed Revenues for Customer Growth. The Company has forecast its costs from 2014 to 2016 by maintaining the estimated cost per customer addition for 2013, and applying inflation to that amount for only 2015 and 2016.¹⁰⁷ Thus, only two years of inflationary increases are applied over the course of the five year Customized IR term.

¹⁰¹ Ex.B2-5-2-5.

¹⁰² Ex.B2-5-2-4.

¹⁰³ Ex.J5.3.

¹⁰⁴ Ex.B2-2-1, p.1 and Ex. B2-10-1, p.32.

¹⁰⁵ See Ex.B2-2-1.

¹⁰⁶ See Ex.B2-3-1.

¹⁰⁷ Ex.B2-2-1, p.4.

The challenge that the Company has imposed on itself for Customer Growth costs is amplified by the fact that Enbridge's actual cost per customer addition for 2013 was \$707 (28%) higher than the forecast used to set costs for 2014 to 2018.¹⁰⁸

In total, Enbridge estimates that the value of the commitment to hold the cost of customer additions to the estimated cost per customer addition for 2013, and applying inflation to that amount for only 2015 and 2016, is around \$25 million per year. This amounts to around \$125 million over the Customized IR term.¹⁰⁹

(c) *Third Party Requirements*

Enbridge has forecast increased levels of relocations costs over the Customized IR term. These are costs incurred when a third party requires Enbridge to move its pipeline to accommodate construction or other activity that conflicts with the pipeline. As Mr. Taylor explained in cross-examination:

Unfortunately, for the most part in relocation work, we are at the mercy of the municipality or third party agency requesting the relocation.

We have to meet their timelines; we have to meet their budget. We begin with the premise that our pipe is in a perfectly good spot and it is perfectly fine. We would rather not move it.

So we do not undertake any sort of feasibility study or movement in time deferral of the projects. We have to work to their needs.¹¹⁰

There is an increased level of third-party infrastructure activity forecast in the coming years. Examples are transit projects (the York Regional Rapid Transit Corporation and MetroLinx) and activities required from the PanAm Games. This increased level of activity is forecast to translate into higher Enbridge costs for relocations activities, as compared to prior years.¹¹¹

¹⁰⁸ Ex.J6.1.

¹⁰⁹ Ex.J1.6, p.3.

¹¹⁰ 6Tr.29.

¹¹¹ Ex.B2-4-1.

(d) Needs of the Company to sustain operations

Many of Enbridge's capital spending requirements in the coming year are focused on "business as usual" type spending, to be able to continue to provide safe and reliable distribution and storage service. This is seen within many of the capital business areas, including Storage¹¹², Facilities and General Plant¹¹³, Business Development¹¹⁴, Information Technology¹¹⁵ and aspects of System Integrity and Reliability¹¹⁶. Generally speaking forecast spending within these areas is at or around historic levels. There was no significant attention paid to these areas of spending over the course of the oral hearing.

(e) WAMS project

A fifth significant driver of capital costs is the WAMS project.

For the past 10 years, the Company has utilized the services of Accenture under the Envision Project pursuant to a 10-year contract which was set to expire in March 2014.¹¹⁷ Under this agreement, Accenture hosted the technology and provided services which allowed the Company to undertake many of its primary core functions, such as the construction, maintenance and service of its assets. As noted in a response to a question from the Board, it was the expectation of Enbridge that at the conclusion of this 10-year contract, the existing technology utilized by the Envision project would be nearing end of life.¹¹⁸ This is in fact the case as the existing technology will in the near future no longer be supported by its vendor and will become obsolete.¹¹⁹

¹¹² Described within Ex.B2-6-1: no questions were asked about this evidence at the hearing.

¹¹³ Described within Ex.B2-9-1: no questions were asked about this evidence at the hearing.

¹¹⁴ Described within Ex.B2-7-1: a few questions were asked about NGV expenditures on day 6.

¹¹⁵ Described within Ex.B2-8-1: most questions at the hearing were focussed on WAMS, rather than on the rest of the IT budget – WAMS is discussed below.

¹¹⁶ Described within Ex.B2-5.

¹¹⁷ 6Tr.85.

¹¹⁸ 6Tr.57.

¹¹⁹ 6Tr.86 and 157, Ex.B2-8-2, pp. 5 and 7.

The services provided by Accenture and the existing technology are responsible for scheduling and coordinating work, responding to customer enquiries and emergency responses, updating working asset records after work is complete and providing the key source of data for forecasting, work load planning and asset planning. There are more than 1,000 users, and the existing technology and any future technology must deal with 1.3 million online (external) attacks per month.¹²⁰

With the recognition that the existing technology would in the near future become obsolete and given the risks to the Company's operations by a successful attack or a failure of its systems, it was imperative that the Company look at the available options to provide the tools necessary to continue with the aforementioned core functions.¹²¹

The Company embarked on a rigorous process to consider the options going forward. The pre-filed evidence identifies and compares the available options.¹²² Under cross-examination, Mr. Akkermans gave a detailed explanation of the process which was followed. Briefly stated, the Company struck an internal team with appropriate expertise and experience that invested hundreds of hours looking into the various options. Certain team members made inquiries with more than 20 utilities that have implemented WAMS related projects that were in the midst of such projects and received feedback about concerns and issues to avoid.¹²³

Team members talked to more than 12 system integrators and various product vendors, again, with a view to informing themselves as to the options available and the advantages and disadvantages of each. Team members also consulted various industry research firms including Gartner. Finally, once Enbridge decided to pursue the WAMS project and generated a budget which was based upon all of the research it had undertaken, it retained Sync Energy to undertake an independent third party review both as to the budget amount and the direction that the Company was proposing to

¹²⁰ 6Tr.85 and 151. See also Ex.B2-8-2, p.5 and Ex.I.B18.EGDI.SEC.104.

¹²¹ 6Tr.85 and 155/6; Ex. B2-8-2.

¹²² Ex.B2-8-2, pp 12-16.

¹²³ 6Tr.121.

take.¹²⁴ In Sync Energy's opinion, the budget developed by the Company was in the expected range. Sync Energy also confirmed that given Enbridge's specific situation, the approach being proposed was appropriate.¹²⁵

Importantly, the majority of the WAMS budget will be determined through public tendering processes. The first tendering process for the software vendor has been completed, and the vendor has been selected. Mr. Akkermans confirmed in his oral evidence and under cross-examination that the bid accepted was in line with the cost estimate included in the budget for the software vendor.¹²⁶ The Company is currently in the midst of the RFP process for the system integrator with its selection expected by mid-year. WAMS is expected to go live at the end of 2015, with the transition from Envision continuing into early 2016.

Until that time and to provide an appropriate transition period, the agreement with Accenture has been extended to March 2016.¹²⁷

The Company recognizes that the budget for WAMS totaling \$67.6 million makes it a significant project. It is for this reason that it has gone to great lengths to undertake investigations and to inform itself for the purposes of developing a reliable budget. The Company submits that ratepayers can take comfort from the fact that a majority of the project's actual costs will be based upon bids received through public tendering processes. Ratepayers should take further comfort from the fact that the bidding processes gave flexibility in terms of the parameters of the bids that are made.¹²⁸ For example, Accenture was invited to submit a bid and it was open to it to propose a similar type of arrangement as that with the Envision project. However, as noted by Sync Energy, this is not the direction which utilities are currently pursuing,¹²⁹ and it is

¹²⁴ 6Tr.121/2.

¹²⁵ 6Tr.124; Ex.B2-8-7, Attachment 1.

¹²⁶ 6Tr.86 and 122.

¹²⁷ 6Tr.146.

¹²⁸ 6Tr.139.

¹²⁹ Ex. B2-T8-S1, Attachment 1.

Enbridge's belief that it will ultimately be able to utilize the WAMS tools on a more cost effective basis.¹³⁰

The risks to Enbridge's operations of not replacing the technology are set out in detail in its response to SEC Interrogatory #104.¹³¹ Briefly stated, a failure by the existing technology could result in a negative impact to the level of service the Company is able to provide its customers for work such as constructing new assets, unlocking new gas meters and completing necessary safety inspections. Service quality standards would also be negatively affected as could the Company's ability to operate on a safe and reliable basis. Simply stated, given the importance of the involved functions provided by the existing technology, and the fact that this technology will no longer be vendor supported and will therefore become more vulnerable to attack, the option of extending the Accenture agreement and continuing to rely upon the existing technology beyond early 2016 was considered inappropriate and significantly problematic.¹³²

During cross-examination, the Company's witnesses were specifically asked why the Envision project could not be extended by means of an upgrade similar to what the Company is proposing in respect of its ENTRAC program. It was noted that Envision is a vendor provided program, whereas ENTRAC is a custom designed program operated within Enbridge. The existing technology which Accenture utilizes cannot be simply upgraded. It would require a complete replacement based upon a new architecture and platform.¹³³ In respect of ENTRAC, there is no product available which would replicate ENTRAC and thus the appropriateness of upgrading it, hardware and software.¹³⁴

The Company notes that there has been no serious challenge of its evidence in respect of the need for and cost of the WAMS project. More significantly, there is no evidence that the Company's operations would not be put at significant and unacceptable risk absent replacing the existing technology. There is also no evidence that the Company's

¹³⁰ 6Tr.151; Ex. B2-8-2, p. 2.

¹³¹ Ex.I.B18.EGDI.SEC.104 p. 4.

¹³² 6Tr.150.

¹³³ 6Tr.99

¹³⁴ 6Tr.113-116

proposal to host and utilize the replacement technology in-house is inconsistent with industry best practices and not cost effective. Accordingly, for the above reasons, the Company submits not only that the WAMS project must proceed but also that it has clearly demonstrated the reasonableness of the Budget.

(iii) Productivity within the Capital Budget

Enbridge's filed 2014 to 2018 capital budget includes substantial productivity commitments. That is, the budgets as filed are substantially lower than the costs that Enbridge expects to face. The Company acknowledges that it will have to find ways to accommodate its actual costs through productivity improvements and initiatives. The Company has been clear in its evidence that the initiatives and spending set out in its capital budget are not discretionary.¹³⁵ Thus, Enbridge will need to find productivity and efficiencies which will allow it to incur the variable costs that have not been included in the budget, the additional costs associated with customer additions, and the expected additional costs due to the integrity management programs. It will either find these efficiencies or its return will suffer.

Within Undertaking J1.6, Enbridge has identified the level of "productivity commitments" included within its capital budget. These total around \$162 million over the 2014 to 2018 period, largely related to Enbridge's decision to limit the budgeted cost of customer additions.¹³⁶ In addition, Enbridge has also identified "variable costs" of around \$260 million over the 2014 to 2018 period.¹³⁷ Many of these amounts will likely materialize; however, none are included within Enbridge's capital budget.

While the current list of productivity initiatives is not finalized and the Company acknowledges that it will have to find additional efficiencies over the term of the Plan, Enbridge has provided a list of projects which could result in future benefits.¹³⁸ Consistent with the transparency of the application generally, the Company has

¹³⁵ See, for example, Ex.I.B18.EGDI.STAFF.55.

¹³⁶ Ex.J1.6, pp.2-3.

¹³⁷ Ex.J1.6, pp.5-7.

¹³⁸ Ex.J5.9.

confirmed that it is committed to the tracking and reporting of its productivity initiatives.¹³⁹

In conclusion, it is submitted that the evidence clearly demonstrates that the Company will be challenged to manage its business with the capital budgets as requested, and earn its allowed return. A significant component of the core capital budget reflects the Company's obligation to satisfy the regulatory requirements of CSA Z662-11. Indeed, the evidence is that in some respects, the Company understands that the TSSA has concerns that aspects of the Company's integrity management plan may not go far enough.¹⁴⁰ The forecast capital costs have been rigorously reviewed, prioritized and stripped of all variable costs. The capital costs as proposed are the minimum amounts necessary to meet the Company's obligations to its customers, to meet its regulatory requirements and to provide a fair return. The forecast budgets at the same time embed numerous productivities and incentives for the Company to generate sustainable efficiencies going forward.

4. Cost of Capital

Enbridge has included reasonable forecasts of its costs of debt and equity for the 2014 to 2018 term within Allowed Revenues. These are real costs to be incurred by the Company during the subject years, and are appropriately recoverable in rates.

There are two components to Enbridge's cost of capital – debt costs and cost of equity. Over the Customized IR term, Enbridge proposes to maintain its current capital structure, with 64% debt and 36% equity. The amount of required debt and equity will change each year, based upon the forecasts of capital additions and retirements as result from the existing rate base and the capital budget. Enbridge's overall debt cost rate is forecast to decline, as maturing debt is replaced by new debt at lower rates. At

¹³⁹ 5Tr. 59 and Ex.A2-10-1.

¹⁴⁰ 5Tr.30.

the same time, the cost of equity (which uses the Board's ROE Formula) is forecast to increase.¹⁴¹

Enbridge's treatment of cost of capital within the Customized IR Plan is consistent with the fact that debt and equity costs are legitimate utility costs, recoverable in rates. In an "I Minus X" type of IR plan, the cost of debt and cost of equity are included within the overall revenue requirement or base rates that are adjusted each year by the applicable inflation factor.¹⁴² Under the Customized IR plan approach, there is no such overall annual adjustment. Instead, Allowed Revenue amounts for all five years of the IR term, inclusive of expectations of inflation and productivity, are set at the outset. As such, it is appropriate to forecast debt and equity costs for each year of the Customized IR term, to be included within rates.¹⁴³

Enbridge's cost of debt predominantly relates to long-term debt, which is used to finance most of the Company's debt requirements. Over the Customized IR term, there are a number of existing long term debt issuances which will be maturing¹⁴⁴, and which will be replaced by new long term debt issuances at lower rates. Also, Enbridge will have to issue additional new long term debt to finance new capital spending on items such as the GTA project and increased System Integrity and Reliability activity over the Customized IR term.¹⁴⁵ As with all forecasts of costs within this Application, the forecast costs for the new debt that Enbridge will issue are based upon the best available information from the time of the filing of the evidence in this case.¹⁴⁶ While it is true that the forecast cost rates have changed since the time of filing (some years have gone up,

¹⁴¹ Enbridge's cost of capital requirements for the Customized IR term are summarized at Ex. A2-5-1 and Ex. E1-1-1.

¹⁴² This topic was discussed in testimony at 1Tr.169-171 and 10Tr.21. See also Ex.J1.11.

¹⁴³ 2Tr.155-156; see also Ex. A2-5-1, para. 10.

¹⁴⁴ See Ex. K10.3, Table 1.

¹⁴⁵ Descriptions of the required new debt issuances are set out within Ex.E1-2-1, paras. 3 to 11 and E1-2-2, paras. 3 to 8.

¹⁴⁶ 10Tr.11. A description of each new debt issuance is set out within Ex.E1-2-1, paras. 3 to 11 and E1-2-2, paras. 3 to 8. Further details are set out within Exhibit K10.3, Table 3.

and some have gone down)¹⁴⁷, it would be inconsistent to update only this one aspect of the Company's forecasts while relying upon the Company's June 2013 forecasts for all other aspects of Allowed Revenue. Indeed, over the next five years, the actual cost of debt may end up being either higher or lower than the forecasts within Enbridge's application. The Company is at risk for such variances.¹⁴⁸

Enbridge has issued \$100 million in preference shares, and does not plan to issue further preference shares during the Customized IR term. Therefore, as the overall amount of Enbridge's debt increases, preference shares will be a smaller proportion of the overall cost of debt. The cost of preference shares is fixed at 80% of the prime lending rate.¹⁴⁹

Enbridge has a maximum amount of \$700 million in available short term debt.¹⁵⁰ The amount and proportion of short term debt to be employed varies each year during the Customized IR term. The forecast levels of short term debt have been developed according to the pace of required capital spending and the timing for cash flow needs.¹⁵¹ Essentially, short term debt is used to meet short term funding requirements while capital spending is underway (before additional long term debt is acquired)¹⁵² and to meet ongoing working capital requirements such as short-term gas cost in storage requirements.¹⁵³ As such, it is important to forecast to have a reasonable level of unused short term debt available, to address unexpected funding requirements such as occur when the cost of natural gas temporarily increases.

¹⁴⁷ Ex.J10.4.

¹⁴⁸ 2Tr.61 and 130-131.

¹⁴⁹ 10Tr.76-77.

¹⁵⁰ Ex.E1-2-1, paras. 12-13.

¹⁵¹ 10Tr.9-10. See also Ex.I.A9.EGDI.SEC.41 and Ex.TC2.1, p. 6 (response to SEC Question 25).

¹⁵² Ex.I.A9.EGDI.SEC.41 and Ex.TC2.1, p. 6 (response to SEC Question 25).

¹⁵³ Ex.E1-2-1, paras. 15-16.

Enbridge's forecast cost of equity for the Customized IR term is based upon application of the Board's ROE Formula¹⁵⁴, using forecasts of the input values for each year. The inputs used to determine the forecasts represent the average from seven financial institutions as of February 2013¹⁵⁵, which is the most recent information collected by Enbridge at the time of filing.¹⁵⁶ As is the case with forecast debt costs, while the inputs that are used to forecast ROE have changed since the time of filing (some years have gone up, and some have gone down)¹⁵⁷, it would be inconsistent to update only this one aspect of the Company's forecasts.

Enbridge is at risk for variances – for example, the 2014 Board-approved ROE level is actually higher than what is embedded within Enbridge's 2014 Allowed Revenue amount.¹⁵⁸

5. Operating and Maintenance Expenses

The reasonableness of the Other O&M budgets for the term of the Customized IR plan has been demonstrably proven in several compelling ways. First, the budget was developed using a grass roots bottoms up approach. It was then reviewed and revised by management using a top down approach. Second, the Company's actual Other O&M expenditures in 2013 being about \$5.5 million above 2013 Board approved demonstrates the need for the 2014 Other O&M Budget amount which is only marginally higher than the 2013 actuals. Third, the Other O&M budgets have been benchmarked on a cost per customer basis using two approaches

¹⁵⁴ From the Board's Report on the Cost of Capital for Ontario's Regulated Utilities, issued December 2009.

¹⁵⁵ Ex.E2-1-1. Details of the inputs used to determine ROE forecasts are set out at Ex.I.B17.EGDI.EP.20. The process used to determine the ROE inputs was described in testimony by Mr. Bhatia at 10Tr.57-63.

¹⁵⁶ 10Tr.37-38 and 57.

¹⁵⁷ Ex.J10.4 and 10Tr.69. As explained, if current ROE forecasts for 2014 were used, then the applicable ROE within 2014 rates would have to be increased from the as-filed level of 9.27% to 9.36%.

¹⁵⁸ 10Tr.19-20 and 69.

and by Concentric Energy Advisors Inc. and in all cases, the budgets are found to be very reasonable.

The total net utility O&M expense budget for 2014 is set out in Table 1 Updated at \$425.3 million.¹⁵⁹ As noted in the Table, this figure is comprised of 5 “buckets”, 4 of which make up just under 50% of the total O&M expense and are determined through mechanisms not under review in this proceeding.

Starting with line item 1 in the Table, “Customer Care/CIS Service Charges”, this expense is subject to an approved Settlement Agreement (EB-2011-0226) which provides for the mechanism to determine the costs of Enbridge’s Customer Care and Customer Information System (CIS) costs for the years 2013 to 2018.

The second line item, Demand Side Management (DSM) is subject to a separate regulatory process. The 2014 DSM Budget included in this proceeding is the budget which recently received final approval from the Board in EB-2012-0394.

Pension and OPEB costs are line item 3 in the Table. In EB-2011-0354, Enbridge and other parties agreed that the Company should recover only its actual Pension and OPEB costs over the coming IR term. To facilitate this, the approved Settlement Agreement in that proceeding created a new variance account, the Post-Retirement True-up Variance Account (PTUVA), which operates to credit or recover variances from forecast amounts from ratepayers.

The fourth line item is RCAM, which refers to the Board approved Regulatory Cost Allocation Methodology which was in place and utilized during the first generation IR and which was the subject of a detailed review in the Company’s 2013 rates case. The RCAM methodology has been used to forecast a trend for RCAM amounts for the 2014 – 2016 period which, notably, is downward in each of these years over the prior year. The Company is proposing that the RCAM in 2017 and 2018 be subject to the same adjustment for these years as Other O&M costs.

¹⁵⁹ Ex. D1-3-1, p. 27, Table 1 Updated, line item 6.

In recognition of the fact that the four above-mentioned “buckets” are the subject of the above-noted processes and mechanisms, the attention of parties in this proceeding has been on the fifth bucket, “Other O&M”. It is therefore not surprising that the Company filed extensive evidence in support of its Other O&M budget, broken down by the 14 departments into which these costs are allocated. Table 10 Updated¹⁶⁰ provides a detailed breakdown of where the costs of the Other O&M budget reside within these departments. This Table also notes the evidentiary reference for the prefiled evidence of each of the departments that make up the budget. This evidence explains with granularity the operational needs of each department, any extraordinary circumstances and cost pressures which the department faces in future, current productivity initiatives and a buildup of the budget requested in each of the years 2014 – 2016.

The Company is proposing as part of the annual rate adjustment process for the 2015 to 2018 years, to update the values related to the Customer Care/CIS/DSM and Pension OPEB amounts, to reflect updated forecasts.¹⁶¹ The remainder of Enbridge’s O&M expenses are being set as final amounts within the Allowed Revenue amounts to be approved in this proceeding.

(i) The Other O&M Budget

Many of the core functions and activities of the Company reside in the departments which make up the Other O&M Budget. This budget is clearly critical to the Company’s operations. At Table 1-Updated of the prefiled evidence, Enbridge has identified the Other O&M budgets, Board Approved and actuals for 2013, and its forecasts for each year of the term of the plan. For ease of reference, line 5 is reproduced below:

¹⁶⁰ Ex. D1-3-1, p. 26.

¹⁶¹ Ex. A2-3-1, pp. 5 and 7.

**Summary of Other O&M Expenses
From 2013 Board Approved to 2018 Budget¹⁶²**

	Board Approved	Actuals <u>2013</u>	Budget <u>2014</u>	Budget <u>2015</u>	Budget <u>2016</u>	Budget <u>2017</u>	Budget <u>2018</u>
	(\$Millions)						
Other O&M	219.2	224.7	228.0	231.5	241.0	248.5	256.3

Enbridge submits that the totality of the evidence supports the conclusion that the Company will be hard pressed to operate within the budgets as requested. As stated in evidence, the Company will only be able to operate within the requested budgets where it is able to generate efficiencies and productivity over the term of the Customized IR plan. These productivity initiatives, both those that the Company has identified and those which will be identified and pursued over the term of the Customized IR plan, must deal with the cost pressures which were demonstrated in evidence. These are discussed further below, but it is first appropriate to review the rigorous budget setting process.

(ii) O&M Budget Developed on Bottom Up and Top Down Basis

The budgetary process followed by the Company was lengthy and detailed. The evidence is that each of the departmental managers was asked to prepare a grassroots or bottom up budget by the budget letter produced at TCU 2.19. The purpose of this exercise was to allow the operations managers to prepare a budget based upon each department's needs and experience. While the aggregate of the first iteration of the Other O&M budget setting process is higher than what is being requested in this proceeding, the important objective was to determine what were the needs, pressures and requirements of each of the departments. This is to be expected at every well operated utility.

¹⁶² Ex. D1-3-1, p. 27, Table 1 Updated, line item 5.

The drivers of the increases which were resident in the first iteration budget are detailed in the response to Undertaking J7.9.¹⁶³ Using the Operations Department as one example, it can be seen that the first iteration budget for this department included FTE additions for each of 2014, 2015 and 2016. The initial inclusion of additional FTEs in the first iteration of the Operations Department budget is not surprising given the evidence about the integrity management initiatives that the Company is undertaking. Consistent with this, Mr. Lapp confirmed in oral evidence that with the continued use of steel pipeline assets that are 60 years old but which have a service life in the order of 50 years, increased maintenance, repairs and replacements are to be expected.¹⁶⁴ He also pointed to the condition monitoring and regulated compliance activities that arise with the installation of infrastructure to meet customer growth.¹⁶⁵ Mr. Lapp also explained that with both the expansion of the integrity management plan to include all of the Company's distribution assets and the advances in detection technologies, it is his expectation that defects which have not been capable of detection in the past will be identified necessitating repair or replacement.¹⁶⁶ It is these realities that naturally lead to the conclusion that more staff would be required going forward.

Similarly, the first iteration budget for the Pipeline Integrity and Engineering Department¹⁶⁷ proposed an increase of \$3.3 million in the 2014 budget over the 2013 budget. Of this amount, \$1.8 million related to locates, inline inspections and leaks and corrosion work. This is consistent with the evidence of Mr. Lapp about the increased activity in these areas which will not only continue, they will be expanded. As noted by Mr. Lapp, the fact that an inspection is undertaken once does not mean that it does not need to be repeated in future.¹⁶⁸

This first budget iteration was reviewed by management and it was determined that department managers should revisit the original budgetary requests but limit the

¹⁶³ Ex. J7.9, Attachment, p. 2.

¹⁶⁴ 7Tr.28.

¹⁶⁵ 7Tr.29.

¹⁶⁶ 7Tr.186-189.

¹⁶⁷ Ex. J7.9, Attachment, p. 3.

¹⁶⁸ 7Tr.191.

increases to about 2.24% based upon the Two Component I factor recommended by Concentric, which consists of the GDP-IPI-FDD for materials prices, and the Ontario Average Hourly Wages for labour related prices.¹⁶⁹ Departmental managers were instructed to embed productivity by holding FTEs flat. This alone meant eliminating from the budget the 47 FTEs which the first budget iteration had contemplated hiring in 2014.¹⁷⁰ Managers were also told to plan to manage the additional cost pressures they identified in the first budget iteration through productivity and efficiency gains over the term of the Customized IR plan.

It should be noted that the budget as filed was prepared in the first half of 2013. The Company was not aware at that time of its 2013 Actuals. We now know that the 2013 Other O & M Actuals, which totaled \$224.7 million¹⁷¹, were \$5.5 million greater than the 2013 Board Approved Other O&M budget.¹⁷² As noted by Mr. Kancharla, Enbridge would have preferred to operate at or around its Board Approved Other O&M budget of \$219.2 million, but in the light of the needs of the Company, including the increase in integrity management initiatives and volume of locates, the additional spending was necessary.¹⁷³ It is submitted therefore that the 2013 Other O&M Actual spend is the appropriate starting point for any consideration of future budgets as this is the only and best evidence of the actual costs to undertake the operations which are financed by the Other O&M budget. Certainly, the actual Other O&M spending is evidence of the reasonableness of the 2014 budget.

Of the 2013 Actuals, municipal taxes totaled approximately \$40 million versus the approved Settlement Agreement budget of \$39.3 million.¹⁷⁴ It should be noted that this expense is expected to increase over the term of the plan as a result of the approved leave to construct reinforcement projects, new acquisitions, customer growth, the new

¹⁶⁹ Concentric, Ex. A2-T9-S1, pp. 39-43; Witness S. Kancharla, 10Tr.10, pp. 8/9; Ex. A2.EGDI.CME.6

¹⁷⁰ 7Tr.79.

¹⁷¹ Ex.1-3-1, p. 27, Table 1 Updated.

¹⁷² *Ibid.*

¹⁷³ 7Tr.25.

¹⁷⁴ 7Tr.20.

staff training facility and inflation.¹⁷⁵ These planned additions to the Company's assets portfolio have informed the forecasts presented by the Company for Municipal taxes in evidence. These forecasts have not been challenged from an evidentiary perspective.¹⁷⁶

It is important to note that there are several extraordinary items included in the 2014 through 2016 budgets that have had an influence on the Other O&M budgets for each of these years. Tables 5, 6 and 7¹⁷⁷ provide a year-over-year analysis of the drivers behind the budgetary increases for these years. The important point to recognize is that in each of 2014, 2015 and 2016, once the extraordinary costs are added or removed, the remaining budget increase in each of these years is actually less than the target rate used for the Other O&M Budget. In 2014, the budget includes an extraordinary one-time cost, \$3.3 million, being the effect in 2014 of the staff additions which were made in 2013. These positions, which were hired at different times in 2013 and which were included as only being half-effective (.5 FTE) for budget purposes in 2013, become fully effective in 2014. The 2014 budget must necessarily reflect these FTE levels for the full year.

The 2014 budget also includes the additional hearing costs relating to this proceeding and higher forecasted interest rates on security deposits. By comparison, Table 6 indicates that the 2015 budget was developed based upon a forecast reduction in hearing costs of \$2 million. As a result, the effective increase in the Other O&M 2015 budget over the 2014 budget is only 1.5%, from \$228 million to \$231 million.

Table 7 demonstrates that the core Other O&M budget for 2016 increased by only 2.1%, but it is in this year that the \$4.1 million O&M costs for WAMS first appears. This raises the percentage increase in that year as a result. The budgets for 2017 and 2018 then inflate the forecast 2016 budget at the average of the increases for the years 2014 through 2016.

¹⁷⁵ 7Tr.21/22.

¹⁷⁶ Ex.D1-6-1, p.1.

¹⁷⁷ Ex.D1-3-1, pp. 17-19.

The fact is that but for the extraordinary items identified in Tables 5 to 7, the budgets for Other O&M would not have increased beyond the target rate. The most significant example of this impact is the WAMS project which contemplates taking the ability to undertake the services currently performed by Accenture under the Envision program in-house. Under Envision, the third party contractor, Accenture, provided work and asset management services which allowed the Company to build and maintain its system. With WAMS, the Company will be developing the necessary tools in-house, which will be used by Enbridge and contract staff. There will as a result be an incremental increase beginning in 2016 in the Other O&M expense of \$4.1 million per year. This compares to the Envision costs of approximately \$9 million per year, of which 90% was capitalized. Under WAMS, the payments to Accenture cease with the expiration of the agreement with Accenture in early 2016. It is primarily the addition of the WAMS O&M in the years 2016 through 2018 which increase the budget in those years beyond the targeted rate of increase. It is therefore important to recognize that there has been a movement in costs from the Envision program, which costs were 90% capitalized, to the WAMS costs, which have a \$4.1 million O&M component beginning in 2016. It would be inappropriate to set an Other O&M budget for these years on a formulaic basis without recognizing these costs which have, in effect, migrated.

(iii) Reasonableness of budget despite cost pressures

The prefiled and oral evidence has been very clear that one of the important and primary drivers for increased costs is the enhanced integrity management initiatives of the Company. The Company's undertaking response to J7.6 is an excellent example of this. For 2014, the Company has included only \$89 million for integrity management initiatives within the Operations and Pipeline Integrity and Engineering Departments budgets. Yet, these departments spent \$96.5 million in 2013 on integrity management initiatives.

It should also be recognized that the Company continues to experience significant customer growth in the 1.7 to 1.8% range per year¹⁷⁸ and that this growth will continue over the Customized IR term. At this rate, the Company will have experienced an approximate 9% increase in its customer base and will be obligated to install, operate and maintain all of the assets necessary to serve these customers and undertake all of the expected customer care functions.

In addition to the above, the evidence confirms that there are significant additional cost pressures to which the Company must respond over the term of the custom IR Plan. To remain competitive with other comparator businesses, the Company's HR Manager, Ms. Trozzi, expanded on the Company's response to Board Staff IR #19 confirming in oral evidence that salaries will have to increase in the 3% range, whereas the as filed budgets used only a 2.2% increase.¹⁷⁹ Ms. Trozzi also confirmed, both in written evidence and in oral evidence that employee benefits will likely increase at a 6.1% pace versus the 2.2% used for budgeting purposes.¹⁸⁰ As well, Ms. Trozzi gave evidence that there is no historical ability to look to forecast STIP as a means to finance other activities as the STIP has been fully paid out in the previous 5 years.¹⁸¹

Ms. Torriano orally confirmed the written evidence that while the as-filed budgets have been held to the target rate, the amounts payable to third party contractors will increase at a higher rate (between 3% and 6%) given that outside contractors' employees are often unionized and their rates are set by fixed union contracts.¹⁸²

Importantly, the evidence demonstrates from a benchmarking perspective, that the O&M budgeted amounts are reasonable. Mr. Kancharla confirmed this reasonableness in his oral testimony referencing the cost per customer evidence at pages 20 through 23 of the prefiled evidence.¹⁸³ Table 8, at page 20¹⁸⁴ calculates the Company's cost per

¹⁷⁸ 7Tr.28/29.

¹⁷⁹ 7Tr. and Exl.A2.EGDI.Staff.19.

¹⁸⁰ 7Tr.36.

¹⁸¹ 7Tr.88.

¹⁸² 7Tr.36 and Exl.A2.EGDI.Staff.19.

¹⁸³ Ex. D1-T3-S1, pp. 20-23.

customer for total utility O&M on a constant dollars per customer and on a nominal dollars per customer basis. As noted by Mr. Kancharla,¹⁸⁵ this evidence shows that the O&M expense on a cost per customer basis has been going down using the 2016 constant dollar calculation or has been relatively flat when viewed from a nominal dollars perspective. This evidence clearly demonstrates that the O&M amounts requested for the IR term are reasonable with the important point being that the costs per customer will be declining over the 5-year IR term relative to the 2013 base year.¹⁸⁶

In addition, the Company engaged Concentric to undertake a benchmarking analysis. Results from this analysis indicated that Enbridge is among the most efficient of its industry peers.¹⁸⁷ Concentric came to this conclusion after undertaking a comparison to a peer group of 28 gas utilities chosen to reflect Enbridge's operating profile and undertaking the benchmarking analysis from a number of perspectives.

(iv) Cost Pressures will be managed through Productivity

The Customized IR plan which the Company has presented in this proceeding embeds productivity into the plan with the same effect as where an X Factor is included in a formulaic IR methodology.¹⁸⁸ The difference in this proceeding is that unlike an I Minus X formulaic proceeding, the cost pressures which the Company will face have been identified with a significant degree of granularity. The uncontradicted evidence is that these cost pressures will arise and that the Company must generate efficiencies to manage its operations within the budgets as filed.

The Company has identified numerous productivity initiatives in both its capital and O&M evidence. Some will generate both O&M and Capital savings in time. An example of this is the expanded use of GPS technology once the program is fully rolled

¹⁸⁴ *Ibid.*

¹⁸⁵ 7Tr.38.

¹⁸⁶ 7Tr.38.

¹⁸⁷ Ex. A2-9-1, p. 5, and Appendix A.

¹⁸⁸ Ex.J1.6.

out.¹⁸⁹ Mr. Lapp, in his oral evidence in chief, expanded upon the written evidence in respect of the benefits of GPS technology in future from an O&M perspective. Mr. Lapp explained how there will be time savings associated with locating field assets in emergency and other situations when there is snow or a change has occurred to physical surroundings.¹⁹⁰ It should be noted that the GPS initiative is currently being used to record locations of all new assets and is being expanded to include legacy assets on a priority and opportunistic basis. What this means is that as the GPS technology becomes available in respect of an ever-increasing percentage of the Company's assets, productivities will follow.

Mr. Lapp also referred to the programs which the Company has in place in respect of locates which involves an arrangement that the Company has with qualified contractors which will reduce the need for the Company to send a field locator out to a site to locate buried facilities. Enbridge is also expanding the Locate Alliance Consortium concept, which allows a field locator to provide locates for more than one utility in a single visit. Mr. Lapp advised that this could result in productivity savings in the 10 to 15% range.¹⁹¹

Similar to employing an X Factor, the Company has, with its decision to hold FTEs flat, embedded productivity into the budgets proposed for the term of the Customized IR plan. By holding FTEs flat over the term of the plan, it necessarily requires the Company to manage with the same human resources throughout the term. The Company calculated the value of the FTE productivity savings in its response to Undertaking J1.6.¹⁹² As can be seen, the value of holding FTEs flat increases significantly over time, with the savings calculated for the entire Customized IR term as being more than \$34 million.

A further example of productivity embedded in the plan results from the decision to hold the bad debt expense flat. As noted by Company witness, Ms. Torriano, over the

¹⁸⁹ 7Tr.7, 27 through 32.

¹⁹⁰ 7Tr.7, 29-32.

¹⁹¹ 7Tr.35.

¹⁹² As set out at Ex.J1.6, p. 4. The savings from 2014 to 2016 are set out at Ex. I.A2.EGDI.Staff.19.

previous IR term the bad debt expense averaged \$14 million per year. The Company is proposing instead to forecast a bad debt expense at a recent historic low being the 2013 actuals.¹⁹³ To the extent that the low gas costs experienced in 2013 increase over the term of the Customized IR plan and/or consumption levels increase such that customer bills are higher, it could have a negative influence on the bad debt expense.¹⁹⁴ The Company has noted in its response to Board Staff 19 that the bad debt expense is probably understated by upwards of \$5 million per year.

In addition, the Company has also identified at Board Staff 19 other highly probable cost increases. These cost increases are not speculative. They are, as noted by the witnesses, real costs which have not been included in the Company's budget. They represent no less of a productivity factor challenge which the Company must still manage. The Company calculates that over the term of the plan, these cost pressures will range between \$24 million and \$43 million, per year,¹⁹⁵ with the aggregate totaling \$172.4 million.

(v) Overall Reasonableness

The Customized IR plan is well suited to accommodate Enbridge's O&M spending requirements over the 2014 to 2018 term. Ratepayers benefit from an approach that embeds productivity and sets very aggressive spending targets. Indeed, as noted in evidence, the forecasted O&M cost per customer is lower under the Customized IR plan than would be the case if an I Minus X approach using the parameters established by Concentric was adopted.¹⁹⁶

The Company submits that the Other O&M budgets easily pass the standard of reasonableness if one only looks at the cost pressures which have not been included in the requested budget amounts. The Company is incented to achieve the necessary

¹⁹³ 7Tr.36.

¹⁹⁴ 7Tr.55/56.

¹⁹⁵ TCU 3.14.

¹⁹⁶ Ex.A2-9-1, pp. 51-53.

productivity and efficiency gains, failing which its return will suffer. It has also committed to generate and to provide annual productivity reports.¹⁹⁷ The fact that not all of the productivity initiatives and steps that the Company will take to generate these savings are fully developed or known at this time should not be surprising, as the term of the Customized IR plan is five years. Productivity initiatives will be continually developed, revised and implemented over the term of the Customized IR plan.¹⁹⁸

All of the above leads to the conclusion that the budgets proposed by Enbridge for Other O&M are very reasonable under the circumstances. The fact is that the Company could not operate within the 2013 Board-approved O&M budget of \$219 million. It exceeded this budget by about \$5.5 million. This is the unchallengeable evidence before the Board and the only reasonable point to begin consideration of the Company's Other O&M budgets for Customized IR plan term. Given the actual spending on Other O&M in 2013, it is submitted that it is simply not credible to suggest that the budgets as proposed are not reasonable.

6. Volumes and Revenues

The volume forecasts for general service and contract volumes filed in evidence in this application, with one exception, have been prepared based on the approved methodologies applied in prior rate case filings.

Total customers are reported on an annual average of monthly customer numbers. The methodology utilized by the Company to calculate the average number of customers is set out at Appendix B to the prefiled evidence.¹⁹⁹ It is the same methodology that has been applied to calculate Board approved annual average customers for more than 10 years.

¹⁹⁷ 7Tr.168.

¹⁹⁸ Ex.J1.6.

¹⁹⁹ Ex.C1-2-1.

The general service volume forecast is derived using the general service customer budget and the normalized average use per customer forecast generated from the average use forecasting models which utilizes Company developed regression models which are described in the pre-filed evidence.²⁰⁰ The forecast incorporates economic assumptions from the economic outlook which was also filed in evidence.²⁰¹ The data set included in the economic outlook was obtained from multiple third party independent sources and includes actuals from 2008 and forecasts to 2016. The data includes Canada, U.S. and Ontario Real GDP and housing starts. It also includes detailed data and forecasts for the Company's three operating regions. The Company proposes to follow the same forecast methodology that has been approved by the Board and used for some years with the exception of the proposal to adopt a heating degree day methodology, which is a hybrid of two historically reliable methodologies, thereby creating a more predictive model for use during the term of the plan.

Contract market volumes have been forecast using the established grassroots approach. Volumes are forecast on an individual customer basis by account executives in consultation with customers who advise as to their need or ability to meet contracted rate class minimum volumes and load requirements. Current economic and industry conditions and budgeted degree days are factored into the budget determination.²⁰²

The Company has included the historical normalized actual and Board-approved general service average use and contract customers normalized volumes in the prefiled evidence.²⁰³ It is noteworthy that residential average use has declined steadily over the period of 2004 through 2012 at a rate of approximately 1.5% per year.²⁰⁴ Residential average use is forecast to continue to decline for a number of reasons, including

²⁰⁰ Ex.C2-1-3.

²⁰¹ Ex.C2-1-1.

²⁰² Ex.C1-2-1, p. 4.

²⁰³ Ex.C1-2-1, Appendix A.

²⁰⁴ Ex.C1-2-1, p. 6.

replacement of less efficient appliances, home insulation improvements and conservation initiatives.²⁰⁵

During the 2006 to 2010 period, the small apartment, commercial and industrial (Rate 6) average use per customer increased an average of 6.7% per year due primarily to migration of contract market customers to general service.²⁰⁶ However, since this time this rate migration has stabilized and the Rate 6 average use per customer turned relatively flat and has recently exhibited a downward trend. Accordingly, it is expected that Rate 6 average use per customer will decrease in 2014 in comparison to 2013 Board-approved driven primarily by customer volatility in the industrial sector and efficiency improvements in apartment sectors.

The Company is forecasting a decrease in the general service volumes of $111.9 \times 10^6 \text{m}^3$ on a weather normalized basis due primarily to lower average use by Rate 1 customers totaling $105.5 \times 10^6 \text{m}^3$ and lower average use per customer in Rate 6 totaling $106.6 \times 10^6 \text{m}^3$. These declines are partially offset by net customer growth of $105.7 \times 10^6 \text{m}^3$.²⁰⁷

The 2014 large volume budget is expected to see an increase of $24.9 \times 10^6 \text{m}^3$ compared to the 2013 budget on a weather-normalized basis. The increase is mainly due to increased activity in the industrial sector and apartment sector, offset by a decrease in the commercial sector.²⁰⁸

While the application includes gas volume budgets for 2015 and 2016, the Company proposes to update the gas volume budget in each year from 2015 through 2018 in annual rate adjustment proceedings. More specifically, in advance of each year (i.e. 2015 – 2018), the Company will provide an updated forecast of volumes (using an updated unlocks forecast based on the preset customer additions forecast and other

²⁰⁵ *Ibid*, p. 7.

²⁰⁶ *Ibid*, p. 8.

²⁰⁷ Ex.C1-2-1, p. 10.

²⁰⁸ Ex.C1-2-1, pp. 10/11.

economic data in applying the approved methodologies and processes for Heating Degree Days, average use and large volume forecasts, revenues and gas costs).²⁰⁹ This updated data will then be applied to the approved Allowed Revenue for each year to derive final rates for 2015 to 2018.

The Company submits that it is prudent to update both volumetric projections and gas cost forecasts to reflect more accurate actual data which will reflect the current economic environment and the impact of the GTA Reinforcement Project. As noted by Ms. Suarez while under cross examination, one of the benefits of updating volumetric forecasts is that it will capture differences between the prior year's forecast and the actuals which include customers that come online in a subject year.²¹⁰ This means that if there is a clear commitment by a prospective new customer to accepting volumes, it would be included in the update.²¹¹

Enbridge believes that annually adjusting for volumes, revenues and gas costs, which it is noted occurred within the first generation IR plan, continues to be reasonable as it involves factors which are difficult to predict and largely outside of the Company's control. In this way, such unpredictable factors are not baked into the term of the Customized IR plan. As a result, neither the Company nor ratepayers gain or lose from variations from these unpredictable forecasts.²¹² To simplify the annual adjustment process, it is proposed that the more predictable customer additions forecast numbers presented in evidence in this application²¹³ be used for each year of the term of the plan (i.e. for 2014 to 2018). It is submitted that this is appropriate given that the cost

²⁰⁹ Ex.A2-1-1, p. 34.

²¹⁰ 7Tr.13.

²¹¹ 7Tr.17.

²¹² Ex.A2-1-1, p. 34.

²¹³ Please see the Customer Growth Capital Budget evidence (Ex.B2-2-1, p. 2) and the Gross Customer Additions Evidence (Ex.B3-2-1, p. 1). The customer additions for 2017 and 2018 are forecast at the same level as 2016: Ex.C1-2-1, Appendix B, p.2.

forecasts developed by the Company which are proposed to be used over the term of the plan are premised on the same customer addition numbers.²¹⁴

The degree day methodology proposed by the Company for use during the term of the Customized IR plan is the hybrid or average of the 20-year trend and 10-year moving average methodologies which have both been approved for the Central region in the most recent decisions. The Company tested the use of this methodology using the Board-approved evaluation framework to validate its reliability and persistence compared to the other methodologies.²¹⁵ The Company found that the hybrid's performance shows marked improvement over both the 20-year trend and 10-year moving average methodologies scoring six points better than the 10-year moving average and four points better than the 20-year trend using data to 2012.²¹⁶ This analysis supports the Company's proposal to use the 50/50 hybrid methodology to forecast degree days for the central weather zone. The Company proposes the de Bever with Trend method for the eastern weather zone and the 10-year moving average for the Niagara weather zone, which are the methodologies used by the Company in 2013 for these regions.

It is noteworthy that the Company's evidence in respect of the proposed degree day methodology has not been challenged by any evidence filed. Indeed, no degree day questions were put to the panel responsible for this evidence during the oral proceeding. Similarly, there were no questions about the Company's UAF forecasts. As well, there is no evidentiary basis to challenge the economic assumptions used by the Company in its forecasts. The Company therefore requests approval of the forecasts and methodologies as proposed.

²¹⁴ Ex.A2-3-1, p. 9.

²¹⁵ Ex. C2-1-2.

²¹⁶ Ex. C2-1-2, p. 10.

7. Enbridge's Site Restoration Costs Proposal

As at the time of the 2011 depreciation study completed by Gannett Fleming (GF), Enbridge's SRC had accumulated to more than \$700 million. GF carried out a two-phase review of net salvage calculations and recommended that Enbridge adopt a Constant Dollar Net Salvage (CDNS) approach to SRC. Based on GF's recommendation, Enbridge proposes to return \$259.8 million to customers by way of a rate rider that is not directly included in Allowed Revenues. The other impacts of adopting GF's recommendations result in reductions to Allowed Revenues cumulatively totaling \$241.4 million over the five years of the Customized IR plan. Thus, in Enbridge's circumstances, the adoption of the conceptually preferable CDNS methodology results in both a substantial refund to customers and reduced rates over the term of the Customized IR plan.

GF has, over the years, completed a number of full and comprehensive depreciation studies for Enbridge. GF's most recent study (the 2011 Study) was based on a review of assets in service through December 31, 2010. As at the time of the 2011 Study, a large amount of over \$700 million had accumulated for SRC relating to the future retirement or removal of assets.²¹⁷

Following the completion of the 2011 Study, Enbridge asked GF to review the net salvage calculations and GF proceeded with a two-phase review. First, GF carried out an analysis of the potential that net salvage percentages for two of Enbridge's largest asset accounts (Distribution Mains and Distribution Services) might not be appropriate in current circumstances. As a result of the Phase 1 review, GF concluded that net

²¹⁷ Ex.D2-1-1, p. II-2.

salvage rates for the Distribution Mains account may be too large and that alternative approaches should be investigated.²¹⁸

Second, GF undertook a review of alternative methods and detailed calculations of net salvage percentages.²¹⁹ As a result of the Phase 2 review, GF recommended that Enbridge use a CDNS approach in the development of net salvage percentages.²²⁰ Under the CDNS approach, historic transactions are revalued to a current cost to allow for a current cost percentage of net salvage with the impacts of historic inflation removed; the current cost estimate is then inflated using appropriate estimates for future inflation.²²¹

Based on the application of the CDNS methodology, the reserve amount required by Enbridge for SRC is smaller than currently has been collected and lower depreciation rates are required on a going-forward basis.²²² Enbridge proposes to return \$259.8 million to customers by way of a rate rider. The rate rider amounts do not directly affect rates and are not included in Allowed Revenues, but would have bill impacts in the form of lower customer bills than would the case in the absence of the SRC proposal.²²³

The return of \$259.8 million to customers indirectly affects rates and Allowed Revenues in two ways. First, as amounts are refunded to customers, accumulated depreciation is reduced, net rate base in turn increases and Enbridge's cost of capital is applied to a higher rate base. Second, the return of amounts to customers gives rise to a tax deduction which lowers taxes payable. As well, a third impact on rates and Allowed Revenues occurs by reason of lower depreciation rates going forward. Taken all together, the three effects of the SRC proposal on Allowed Revenues result in a

²¹⁸ Ex.D2-1-1, p. II-3.

²¹⁹ Ex.D2-1-1, pp. 11-2/3

²²⁰ Ex.D2-1-1, p. III-2.

²²¹ Ex. D2-1-1, p. II-5.

²²² Ex.K9.1, p. 1.

²²³ Ex. K9.1, pp. 1-2.

cumulative reduction of \$241.4 million over the five year term of the Customized IR plan.²²⁴

While it may be that some questions during cross-examination implied a negative view of the SRC proposal, Enbridge submits that the Board should see the proposal as a positive aspect of Enbridge's application. The SRC proposal has both a rate mitigation and a bill mitigation effect; these effects are timely and opportune in that, as stated above, Enbridge is able to meet important capital spending needs and at the same time implement a proposal that moderates rate and bill impacts.

Two very different areas of enquiry emerged during cross-examination on the SRC proposal at the hearing. One was that the application of the CDNS methodology should be carried forward to a more recent date than that of the 2011 Study because this might be anticipated to increase the amount by which the reserve under the current methodology exceeds the reserve under the CDNS methodology.²²⁵ In contrast to the suggestion that the application of the CDNS methodology should be carried forward to a more recent date, another area of enquiry related to the extent to which the CDNS methodology has been adopted by other utilities.²²⁶

As to the idea that the application of the CDNS methodology might be carried forward to a more recent date, Mr. Kennedy from GF pointed out that it is typical for full depreciation studies to be done periodically and for there to be a "lag" between the timing of calculations and the timing of implementation.²²⁷ In this regard, he testified that,

...there is a timing difference of when we made the calculations and developed the salvage percentages to the point in time they're going to be

²²⁴ Ex. K9.1, p. 3.

²²⁵ 9Tr.81-102. See also 9Tr.174-175 and 9Tr.196-198.

²²⁶ 9Tr.215-219.

²²⁷ At 9Tr.138, Mr. Kennedy stated that: "...it is very common to have a three- or four-year lag in the depreciation rates that occur due to the timing of the utility or the ability of the utility to implement our depreciation studies."

implemented. That lag is, quite frankly, quite common in doing depreciations studies.

That's in part why we recommend to regulators and utilities both that there is a periodic true-up, if you will, of the depreciations rates.

...So what I'm getting at is when we do the study again, probably in 2017 or 2018, we will look at the accumulated depreciation balance that exists, we will compare that to what we think it ought to be, and then we will again recommend a mechanism for truing that up at that point in time.²²⁸

In fact, Mr. Kennedy explained, in the following testimony, that the remaining life basis of depreciation used by Enbridge is inherently self-correcting:

Now, that remaining life basis has got an inherent true-up to deal with precisely this type of regulatory lag – or in part, I guess is a more correct form

In other words, the remaining life basis says: I compare my actual accumulated depreciation number to my calculated or my theoretical number at a point in time; very often, one or two years behind the actual sitting in the hearing room here.

We take that variance and we amortize that over the remaining life of the assets.

...the precedent of this Board has been to approve depreciation rates calculated on a remaining life basis, that inherently have a true-up mechanism to deal with this type of regulatory lag.²²⁹

Later, Mr. Kennedy testified that, as depreciation studies continue to be prepared for Enbridge on a periodic basis, he does not expect variations of the same magnitude as the amount in this case that resulted from a change in methodology. His expectation is that future variations will be more in line with those that occur whenever a full depreciation study is performed.²³⁰

²²⁸ 9Tr.81-82.

²²⁹ 9Tr.143.

²³⁰ 9Tr.214.

Mr. Kennedy also emphasized the importance of reliable analysis and empirical data to support conclusions or decisions about accumulated depreciation numbers. His evidence was that,

We did an extensive amount of work, we did an extensive amount of modelling, and we have some very empiric data that allows me to be very comfortable at 292.

I get a bit hesitant ...[about] ... fuddling around with those accumulated depreciation numbers on the basis of softer and not quite so solid assumptions.

And quite frankly, very quickly, the more of that that occurs that isn't based on solid empiric evidence, you can very quickly turn surpluses into deficits, you can turn deficits into surpluses, and you can have very, very wide swings in utility tolls.²³¹

As to the question about the extent to which the CDNS methodology has been adopted by other utilities, Mr. Kennedy referred to CDNS as a much better methodology, but observed that its use is affected by its association with higher rates for utilities. These points were made in the following testimony:

What we find in most utilities, when we look at use of the CDNS method, it results in a rate increase. And quite frankly, as regulators or stewards of the public purse, if you will, in terms of the tolls, it is a very tough suggestion to say: I have a really nice new economic theory for you that I believe is much better, but results in a toll increase.²³²

Indeed, Mr. Kennedy indicated that he perhaps did not push the CDNS methodology with Enbridge as much as he should have because of an assumption that it would cause rates to go up.²³³ The circumstances of Enbridge, though, are such that the use of the "traditional" method has resulted in negative salvage percentages that are "generically", "systematically" and "substantially" higher than the comparators used by GF.²³⁴ Mr. Kennedy provided the following elaboration on Enbridge's circumstances:

²³¹ 9Tr.174-175.

²³² 9Tr.216. See also 9Tr. 180-183.

²³³ 9Tr.183.

²³⁴ 9Tr.175.

Quite frankly, this utility was of such an age over those periods of, you know, high inflation, in the 1980s that they were retiring flat at a higher rate than perhaps some of the more younger utilities that we'd see, for example, maybe in Alberta and stuff, that predominantly built themselves in the 1960s and '70s.

So this utility was a little bit unique in that we had some – we had more data that really had this influence of this impact of those high inflationary periods.²³⁵

Thus, Mr. Kennedy noted that Enbridge's circumstances are different from those of many Canadian natural gas utilities. While he agreed that Enbridge is not significantly different from utilities in the northeast United States, he noted that some of those utilities have adopted similar methods that seek to normalize periods of high inflation out of the rate calculations.²³⁶

Finally, in response to a question about whether there could be a discussion five years from now about Enbridge reverting to the "traditional" methodology, Mr. Kennedy said that the particular circumstances of Enbridge that caused the CDNS calculation to result in a reduction to SRC will not change over the next five years. He went on to say that, if inflation were to go "silly" over the coming five-year period, this could result in a need to increase SRC recoveries, but he added that, even in such a scenario, he is not certain that recoveries would need to go up any more under the CDNS methodology than under the traditional approach.²³⁷

In short, Enbridge's particular circumstances are such that, not only is the CDNS approach a conceptually preferable methodology, it also results in both a substantial refund to customers and reduced rates over the term of the Customized IR plan. Through the course of lengthy cross-examinations on the SRC issue, there was no substantive challenge to the merits of the CDNS methodology or Enbridge's proposal

²³⁵ 9Tr.176.

²³⁶ 9Tr.219. See also 9Tr.216.

²³⁷ 9Tr.218.

that an amount of SRC be returned to customers. For all of these reasons, Enbridge submits that the SRC proposal should be approved by the Board.

8. Particular Features of Enbridge's Customized IR plan

The Customized IR plan contains mechanisms and features that are appropriate for a five year incentive regulation plan. Among other things, these will encourage investments in sustainable efficiency measures, share rewards between the utility and ratepayers for superior performance, and protect the utility and ratepayers from consequences of significant unexpected cost changes beyond the utility's control.

Certain features of the Customized IR plan, such as the 5-year term²³⁸, performance measurement/reporting²³⁹ and the proposed Off-Ramp²⁴⁰, did not give rise to issues at the oral hearing of this proceeding. This section of Enbridge's argument in chief will address features of the Customized IR plan that were the subject of questions during the oral testimony, namely, the annual rate adjustment process, the Z Factor, the ESM and the SEIM. Also addressed is the benchmarking and econometric evidence filed by Concentric that demonstrates the efficiency of Enbridge's past operations, and the reasonableness of the budget amounts for the Customized IR term.

(i) Annual Rate Adjustment Process

As was the case in Enbridge's 1st Generation IR plan, the Customized IR plan provides for an annual rate adjustment process.²⁴¹ While most constituent parts of Allowed Revenue for each year from 2014 to 2018 will be determined in this proceeding, there will be certain items that will be updated annually. Under this rate adjustment process, forecast volumes and items of a "pass-through" nature will be updated each year, in

²³⁸ As described at Ex.A2-1-1.

²³⁹ As described at Ex.A2-11-2.

²⁴⁰ As described at Ex.A2-6-1.

²⁴¹ 1Tr.125; see also Ex.A2-3-1.

order to set rates for that year. Essentially, the placeholder amounts for these items included within Allowed Revenues and preliminary rates for 2015 to 2018 will be updated for the relevant year.

The main items that will be updated within the rate adjustment process are: (i) volumes (although the customer additions aspect of volume forecasts will be set within this proceeding for all five years)²⁴²; (ii) gas-cost related items²⁴³; (iii) other pass-through items (updated amounts for customer care/CIS calculated in accordance with the Board-approved EB-2011-0226 Settlement Agreement and annually updated forecasts of pension and OPEB costs).²⁴⁴ The rate adjustment process is intended to be a streamlined summary process, to allow for rates to be in place in advance of each subject year, while making use of the most current available information and forecasts for those items which will be updated.²⁴⁵

(ii) Z Factor

There does not appear to be any debate that a Z Factor is an appropriate feature of an IR mechanism. This is recognized within the Natural Gas Forum Report.²⁴⁶ The RRFE Report includes Z Factor protection within all three ratesetting methods.²⁴⁷ Dr. Kaufmann also acknowledged that there is a role for Z Factors within IR plans, to cover “unexpected contingencies”.²⁴⁸

The wording of the Z Factor criteria within Enbridge’s 1st Generation IR plan was difficult to decipher, interpret and apply. For example, the requirement that the “cost” in issue must not be “a risk in respect of which a prudent utility would take risk mitigation measures” is quite unclear. Indeed, Dr. Kaufmann acknowledged in written and oral

²⁴² Ex.A2-3-1, para. 17.

²⁴³ Ex.A2-3-1, para. 18.

²⁴⁴ Ex.A2-3-1, para. 20.

²⁴⁵ Ex.A2-3-1, para. 23 and 7Tr.13 and 17.

²⁴⁶ Ex.A2-4-1, para. 4, citing the NGF Report.

²⁴⁷ RRFE Report, at p. 13.

²⁴⁸ 4Tr. 89, 147 and 157.

testimony that the Z Factor wording from Enbridge's 1st Generation IR plan is not clear²⁴⁹ and can be interpreted in various ways.²⁵⁰

Within the Customized IR plan, Enbridge proposes to update the description and criteria applicable to Z Factors, to make the evaluation of potential Z Factor requests more clear and consistent. As Mr. Ryckman explained in response to a question from Ms. Chaplin:

I think with the original Z factor language, the main problem we had was that there doesn't appear to be anything that would qualify, which basically means that there is no Z factor. And presuming that Z factors are a relevant feature of an IR plan, then there should be some enhancements made to the language. So it is not necessarily looking to increase the number of Z factors that would come before the Board, but, once again, if we don't have language that allows for a Z factor to be properly considered, to come before the Board and be properly considered, you effectively don't have a Z factor framework or a Z factor parameter within the plan.²⁵¹

There is no intention to change the risk allocation that existed under the 1st Generation IR plan.²⁵² The Company's proposed Z Factor wording is consistent with the Board Staff Discussion Paper that addressed Z Factors for Ontario gas utilities.²⁵³

The particulars of Enbridge's Z Factor proposal are set out and explained in evidence²⁵⁴, and were discussed in testimony.²⁵⁵ Beyond removing unclear wording that previously existed, the other main change made is to relate Z Factors to "causes", rather than "events". This is appropriate, as it takes the focus of review away from linking a singular event to all the costs at issue, when there may be a combination of related events all linked to one cause. It is still necessary, though, to demonstrate that

²⁴⁹ Ex.L-1-2, p.24.

²⁵⁰ 4Tr.157.

²⁵¹ 2Tr.148.

²⁵² 2Tr.78-79.

²⁵³ Ex.A2-4-1, paras. 4-6 and 14-24.

²⁵⁴ Ex. A2-4-1. The proposed description and criteria is set out at para. 4, and the explanation is set out in the balance of the evidence.

²⁵⁵ See, for example, 1Tr.51-59.

causes that lead to cost increases or decreases are unexpected, non-routine and outside of management control. Under Enbridge's proposed updated wording, a Z Factor request will only succeed where it is shown that: (i) the costs at issue are driven by a cause that is unexpected and non-routine; (ii) the costs at issue are outside of Allowed Revenue amounts, and meet a materiality threshold of \$1.5 million in revenue requirement; (iii) the cause of the cost increase or decrease is not reasonably within the control of utility management and is not a cause that utility management could prevent by the exercise of due diligence.²⁵⁶ These criteria will be difficult to satisfy, and will not open the floodgates to large numbers of Z Factor requests.

(iii) ESM

Enbridge is not aware that there is opposition to the inclusion of an ESM within the Customized IR plan. The ESM is described here within the Argument in Chief simply because it is an important aspect of the Customized IR plan.

Enbridge proposes to continue the same ESM mechanism as existed in its 1st Generation IR plan. That is, there will be an asymmetrical approach where Enbridge is required to absorb any under-earning (subject to the Off-Ramp), but will share earnings on a 50/50 basis if the earnings are more than 100 basis points above the Board-approved ROE level, calculated each year using the Board's ROE Formula.²⁵⁷ Earnings will be calculated based on actual weather-normalized results (including actual rate base and all other revenue and expense items that would be found within a cost of service application each year).²⁵⁸ The proposed ESM, which leaves Enbridge with full risk of under-earning and also allows the Company to keep the first amount of over-earnings amplifies the incentive for Enbridge to find and implement productivity savings. The sharing of earnings above the deadband provides ratepayers with some of the benefits if the Company succeeds in finding efficiency savings.²⁵⁹ As stated by Ms.

²⁵⁶ Ex.A2-4-1, paras. 14-24.

²⁵⁷ See Ex.A2-7-1, and A2-5-1, pp. 3-4.

²⁵⁸ Ex.A2-7-1, pp.2-3.

²⁵⁹ See testimony of Ms. Frayer, Mr. Coyne and Dr. Kaufmann at 4Tr.91-93.

Frayer of LEI, the ESM also indirectly protects against concerns of overstating capital expenditure forecasts and the build-up of the Allowed Revenue amounts, and then under-spending.²⁶⁰

The other advantage to the ESM is that it provides stakeholders with annual reviews of the Company's actual expenditures and results, during the five year period where costs and revenues are decoupled. This will allow parties to see where changes have occurred relative to forecast costs, to see what items are driving differences in return from what was forecast.²⁶¹ As Ms. Frayer indicated, this also instills a level of discipline on the applicant to provide as best a forecast of costs as possible, since those costs will be under scrutiny during each year of the IR term.²⁶²

(iv) Sustainable Efficiency Incentive Mechanism

Enbridge's Customized IR plan contains a Sustainable Efficiency Incentive Mechanism in recognition of the importance of including incentives to the utility to find and implement sustainable efficiency projects in a regulatory environment that otherwise rewards and encourages short-term cost cutting.²⁶³ The underlying concept of the SEIM is entirely consistent with the OEB's objective that an incentive regulation plan should establish incentives for sustainable efficiency improvements that benefit customer and shareholders.²⁶⁴ As explained by LEI, the goal of the SEIM is to produce incentives for management to undertake long-term sustainable efficiencies and to reduce the potential motivations for management to otherwise delay efficiency-enhancing projects nearing the end of the IR term.²⁶⁵ Mr. Lister addressed this point in cross-examination, stating that

Our concern in particular, as Mr. Shepherd and I were talking, with regard to the SEIM was sometimes the efforts to do -- to be successful in

²⁶⁰ 3Tr.57.

²⁶¹ 1Tr.120.

²⁶² 3Tr.150-151.

²⁶³ See Ex.A2-11-3.

²⁶⁴ Ex.A2-1-1, para. 20, quoting from the Natural Gas Forum Report.

²⁶⁵ Ex.A2-11-3, Attachment, p.2.

incentive regulation, there's concern or suspicion that there's been cost deferment. And then you show up at a rebasing case and people believe that you just -- you didn't do the spending in IR and now you want to do it in rebasing.

So our proposal with the SEIM was intended to get right around that, and say: Well, if we're interested in long-term sustainable efficiencies, let's measure that.²⁶⁶

Because Enbridge's application represents the first application made to the Board for a Customized IR or a Custom IR plan, Enbridge has tried to be open to comments from stakeholders about the features of the plan. Indeed, in response to stakeholder comments and Dr. Kaufmann's report, Enbridge modified its Customized IR plan in updated evidence filed in December 2013 to remove any doubt about the 5 year term of the plan and to respond to points made about the SEIM. As stated in Enbridge's updated evidence about the SEIM, the updated mechanism was informed by the approved Efficiency Carryover Mechanism (ECM) from Alberta.²⁶⁷ Enbridge also added strict eligibility requirements to the SEIM to improve on the Alberta model and to take into account stakeholder concerns that any potential reward must be conditioned on demonstrating the achievement of sustainable efficiency gains.²⁶⁸ The goal was to adapt the features of an ECM (taking into account Dr. Kaufmann's comment that "PEG has always supported well-designed ECMs"²⁶⁹) to the circumstances of Enbridge's Customized IR plan. Further, Enbridge added onerous conditions to the SEIM, to ensure that no reward would be earned unless it was shown that service quality was maintained, and that the value of efficiency gains being achieved exceeded the value of the reward. As discussed above, while it cannot be suggested that the SEIM is a perfect solution to the issue of creating an incentive for efficiencies that are truly sustainable, the SEIM represents a positive and meaningful effort to improve upon other IR plans that reward cost-cutting during the term of a plan but do not put a specific focus on sustainable efficiencies.

²⁶⁶ 1Tr.164.

²⁶⁷ A2-11-3,

²⁶⁸ 1Tr134-135 and Ex.A2-11-3, p.

²⁶⁹ Ex. L-1-2, p. 29.

As noted, no-one involved in this case has suggested a better way to focus specifically on sustainable efficiencies than Enbridge's SEIM. That being said, it became clear during the oral hearing that Enbridge's updated form of SEIM²⁷⁰ continues to generate concerns from stakeholders, and that the various elements of the proposed mechanism will become the subject of debate.²⁷¹

Enbridge believes that the goals of the SEIM, as described above, are important and should be addressed within the Customized IR plan. The Company continues to be interested in improving the proposed mechanism, to create an approach that all parties can consider as being appropriately designed to motivate appropriate behavior throughout the Customized IR term and reward achievement of sustainable efficiency gains. The Company believes that the appropriate discussion in this regard can address alternatives to the SEIM that has been proposed in evidence and testimony. To that end, Enbridge invites parties to address alternative approaches within their written submissions. The Company can then provide its responding perspective within Reply Argument.

For its own part, Enbridge suggests two alternatives. One is to modify the proposed SEIM to address issues around "double-counting" of efficiency gains achieved during the Customized IR term.²⁷² In Enbridge's view this issue can be avoided by requiring that Enbridge's demonstration of the net present value of efficiency savings be focused exclusively upon gains achieved after the end of the IR term. A different approach could be to undertake a consultative process during the next year to discuss, design and hopefully agree upon an appropriate form of SEIM that can be presented to the Board for approval.

²⁷⁰ As described at Ex.A2-11-3, and Ex.J7.7.

²⁷¹ See, for example, Dr. Kaufmann's testimony that he is "fine with the concept" of the SEIM, but does not endorse the details of the proposed approach: 4Tr.102-103.

²⁷² (by embedding the expectation of productivity savings within budgets, and also claiming the value of such savings to justify a SEIM reward)

(v) Benchmarking and Econometric Evidence

In order to promote productivity and efficiency in utility operations, the Board, the Company and stakeholders will be assisted by understanding the baseline starting point, and realistic expectations for what is possible in the future. These items are addressed in the evidence filed by Concentric.

To create this baseline, Concentric conducted a series of analyses. First, Concentric benchmarked Enbridge's performance across a variety of operating and financial metrics over the 2000 to 2011 period in relation to a group of gas distribution peer group companies.²⁷³ Second, Concentric measured the productivity of the industry and Enbridge over the same period using a total factor productivity (TFP) analysis that measures the efficiency of a utility in converting all of its inputs (labour, capital and materials) into outputs (customers serviced).²⁷⁴ Third, Concentric also performed a more focused analysis on O&M expenses only (excluding capital), with a partial factor productivity (PFP) analysis.²⁷⁵

As discussed in section IV of Concentric's report²⁷⁶, "Evaluation of EGD's Productivity", Concentric's benchmarking, TFP, and PFP analyses demonstrate that: (a) Enbridge is currently an efficient utility, (b) Enbridge has continued to improve its performance relative to its industry peers, and (c) Enbridge improved its productivity during the 1st generation IR plan (2007-2011) compared to the pre-IR Plan period (2000-2007) relative to its industry peers.

Concentric further demonstrated that Enbridge's forecasted O&M is efficient; Enbridge's forecast 2014 – 2018 O&M per customer is lower than the industry average for 2011²⁷⁷, and the cumulative 2014 to 2016 productivity savings based on a comparison of

²⁷³ Ex.A2-9-1, pp.21-26 and Appendix A.

²⁷⁴ Ex.A2-9-1, pp.26-35 and Appendix B.

²⁷⁵ Ex.A2-9-1, pp.35-38 and Appendix B.

²⁷⁶ Ex.A2-9-1, pp.16-38.

²⁷⁷ Ex.A2-9-1, p.51; Ex.I.A1.EGDI.SEC.30.

Enbridge's O&M forecast relative to I Minus X O&M growth is approximately \$12 million.²⁷⁸ These analyses demonstrate the efficiencies that are reflected in Enbridge's O&M forecast.

Concentric also addressed the issue of capital costs and combined capital and O&M costs. Benchmarking results for capital costs are presented in summary and detailed fashion.²⁷⁹ In addition, Concentric provides comprehensive cost comparisons through its TFP analysis. Based on this TFP analysis, which includes both O&M and capital inputs, Concentric determined that Enbridge's productivity was better over the 2007-2011 period than its industry peers, namely the industry group and the seven company utilized by Concentric.

The efficiency and cost effectiveness of Enbridge's capital forecast is further demonstrated in detail throughout the 542 pages of Exhibit B2 of Enbridge's evidence. That being said, the efficiency of a gas distribution company's capital spending plans cannot be reliably evaluated by benchmarking, indexing or trend analyses alone, because capital spending is impacted by circumstances that are unique to that company at a specific point in time. Further, as explained by Mr. Coyne and Ms. Frayer in cross-examination²⁸⁰, it is not apparent that adequate reliable data exists that would allow for meaningful econometric benchmarking of Enbridge's forecast capital costs to be completed. The framework that exists in the UK, where more than half a dozen companies are being simultaneously reviewed and regulated, allows for much more rich data to support detailed econometric analysis than is available in relation to Ontario gas distributors.²⁸¹ While Dr. Kaufmann indicated that he believes such data is available, he confirmed that he did not provide that view to his client (OEB staff) until shortly before

²⁷⁸ Ex.A2-9-1, p.52.

²⁷⁹ Ex.A2-9-1, pp.24-26 and Appendix A, pp. A-6 to A-8.

²⁸⁰ 3Tr.138-139 and 142-143.

²⁸¹ 4Tr.96.

the hearing, and he has not undertaken any econometric benchmarking to evaluate Enbridge's forecast capital costs.²⁸²

9. 2014 to 2018 Deferral and Variance Accounts

Enbridge proposes continuation of most existing deferral and variance accounts, to ensure that neither ratepayers nor the Company benefit or are burdened by items that ought to be cost pass-throughs. There are also a small number of new deferral and variance accounts to address specific circumstances that may arise during the Customized IR term. The new accounts will appropriately ensure that actual costs related to specific projects or activities are recovered.

The list of deferral and variance accounts for which Enbridge seeks approval for the Customized IR term is set out in evidence.²⁸³ Most of the accounts are intended to track costs or revenues in areas where these items are in whole or in part beyond the Company's control, such that it would not be appropriate for ratepayers or the Company to benefit or be burdened by differences from forecasts. In some cases, the accounts are created to ensure that the Company can properly implement prior OEB decisions. Most of these deferral and variance accounts are simply continuations of existing gas and non-gas accounts. There are proposed changes to a small number of existing deferral and variance accounts, to address evolution of circumstances. These are described in evidence, and were discussed in testimony.²⁸⁴ The balances in each account will be presented for clearance or review following the end of each year of the Customized IR term (on a quarterly basis in the case of the PGVA).

²⁸² 4Tr.126-128.

²⁸³ Ex.D1-8-1, pp. 2-3. Ex.J2.1 sets out which accounts will be in place each year of the term.

²⁸⁴ The relevant accounts are listed at Ex.D1-8-1, p.2 (GDARIDA, TIACDA, TSDA and DSMVA), and details of the proposed revisions are set out in the body of that evidence and were highlighted in testimony by Mr. Culbert : 11Tr.52-53 and 66-67(GDARIDA), 11Tr.42-43(TSDA), 11Tr.68-69(TIACDA) and 11Tr.69-70(DSMVA).

There does not appear to be opposition to maintaining most of Enbridge's existing deferral and variance accounts. The one existing account that received significant attention at the hearing is the Ontario Hearings Cost Variance Account (OHCVA). As stated by Mr. Culbert, the intent of this account, which has been approved for more than 15 years (often in Settlement Agreements),

is to keep both sides, the ratepayers and the company, whole for the types of costs that are incurred in a regulatory proceeding, which is the requirement for a regulated entity in Ontario to face. I agree that we -- the purpose of the OHCVA is that neither party faces an additional risk.²⁸⁵

The types of costs that are included within the OHCVA are unpredictable, and largely out of the Company's control. From year to year, it is very difficult to forecast costs from rate proceedings, generic proceedings, consultative processes, stakeholders and the Board's own costs.²⁸⁶ As explained by Mr. Culbert,

To forecast costs for regulatory proceedings, there's a multitude of things that influence the costs: stakeholder, Board interests and involvement in proceedings, and in fact perhaps generic proceedings that are faced by entities in Ontario; ourselves for sure.

Recent examples of that are questions and answers on -- I am not sure which day it was of this proceeding by Board Staff in terms of potential generic proceedings that might come about for funds required for abandonment costs and SRC proposals. Might there be generic proceeds for funds for OPEBs which were part of the question and answer between Board Staff and ourselves. Recent suggestions within our QRAM proceeding, which we are just going through, by CCC as to there being a potential rehearing or a generic proceeding for those.

So those are the circumstances that we see, and we believe make it reasonable that an OHCVA is resident within our applications and going forward, such that both the ratepayers and the company aren't going to benefit at the expense of the other.²⁸⁷

There is no assurance that amounts recorded within the OHCVA will be recovered. All such amounts must be presented for approval within the annual ESM proceedings, and

²⁸⁵ 11Tr.37.

²⁸⁶ 11Tr.31-32.

²⁸⁷ 11Tr.31-32.

are subject to review before any OHCVA clearance is approved.²⁸⁸ In Enbridge's view, this provides appropriate transparency and oversight of regulatory costs, and actually provides the Board and parties with greater understanding and control over the recovery of such costs than would be the case if the costs were an undivided part of the overall Allowed Revenues.

Within the Board's November 5, 2013 Decision on Motion, the Board approved a new gas-related deferral account for 2014 related to Unabsorbed Demand Costs that may arise from Enbridge's procurement of FT transportation (the 2014 UDCDA). As indicated in testimony, Enbridge will seek the continuation of that account for future years within rate adjustment proceedings for the relevant years.²⁸⁹

Enbridge also seeks approval of several new deferral and variance accounts.²⁹⁰

The most notable of these new accounts relates to the costs of the GTA project, which was approved by the Board on January 30, 2014. The GTAPVA will ensure that the amounts ultimately recoverable in rates for the GTA project will reflect the actual costs and timing of the project, which is an important protection for all parties, given the very large size and financial impact of the project.²⁹¹

Two other new accounts relate to Enbridge's capital costs from relocations and replacement mains activity in the last two years of the Customized IR term. These accounts arise from Enbridge's proposal to set its 2017 and 2018 capital budgets at the 2016 level, without any allowance for potential new costs during those years. As indicated in testimony, it will be very challenging for the Company to maintain its

²⁸⁸ 11Tr.74.

²⁸⁹ 8Tr.22-23.

²⁹⁰ The relevant accounts are listed at Ex.D1-8-1, p.2 (CCSPDA, GGEIDA, CDNSADA, GTAPVA, RLMVA and RPMVA).

²⁹¹ The Company is also seeking 2015 to 2018 approval of the Greater Toronto Area Incremental Transmission Capital Revenue Requirement Deferral Account, which was approved in an Accounting Order on March 11, 2014 (see Ex.D1-8-7).

spending at that level.²⁹² That is particularly true in the case of relocations, which are situations where a third party public authority requires Enbridge to move its existing pipes to accommodate work projects, and in the case of mains replacement requirements identified through pipeline inspection activities. While Enbridge has indicated that it is prepared to take the risk of accommodating the cost of these activities within its filed budgets from 2014 to 2016, the risk associated with these areas for 2017 and 2018 is too extraordinary.²⁹³ Rather than proposing higher Allowed Revenue amounts associated with spending in these areas for 2017 and 2018, the Company has instead proposed an approach whereby variance account treatment is available if a certain level of spending over the amount included in Allowed Revenue is required.²⁹⁴ This offers a balancing of risks between Enbridge and ratepayers. Enbridge is protected from having to absorb what could be significant costs arising from factors generally beyond its control. Ratepayers are protected by the fact that Enbridge has not increased its capital budgets for 2017 and 2018, and by the fact that Enbridge will not be able to recover any overspending unless the costs for either relocations or mains replacements are around \$15 million higher than what is included in the base budgets for those items.²⁹⁵

10. Cost Allocation and Rate Design

Enbridge proposes continuation of its existing Fully Allocated Cost Study methodology, and has proposed very modest changes to the eligibility criteria for a couple of contract rates. Enbridge is seeking approval of a new Rate 332 that will apply to Shippers using Parkway to Albion Transportation service on Segment A of the GTA project.

²⁹² 4Tr.176 and 191

²⁹³ 6Tr. 70-71

²⁹⁴ The proposed variance accounts, the RLMVA and the RPMVA, are described at Ex. D1-8-6.

²⁹⁵ 5Tr.166

Enbridge has filed its 2014 Fully Allocated Cost Study that has been used to determine rates for 2014.²⁹⁶ There are no changes to the cost allocation methodology from recent years.²⁹⁷ The Company will include updated Fully Allocated Cost Studies within the annual rate adjustment proceedings during the Customized IR term.

Enbridge has proposed some small changes to Rates 100²⁹⁸ and 110²⁹⁹, as well as a small addition to the Terms and Conditions within the Rate Handbook that relate to large customers.³⁰⁰ There does not appear to be any opposition to this request.³⁰¹

The Company understands that APPrO will be arguing for changes to cost allocation methodology for Rate 125. While APPrO filed an expert report containing recommendations around changes to cost allocation for Rate 125³⁰², it became clear during the hearing that APPrO's position may differ from that presented in the Elenchus report.³⁰³ As APPrO may choose to advance a position that differs from the views or recommendations set out in the Elenchus report, Enbridge will wait until having reviewed APPrO's argument about Rate 125 before providing a response.

The Company is also seeking approval of Rate 332: Parkway to Albion Transportation Service.³⁰⁴ Enbridge is not aware of any opposition to this request.

²⁹⁶ Ex. G2-1-1.

²⁹⁷ Ex. G1-1-1

²⁹⁸ Ex. H1-2-2

²⁹⁹ Ex. H1-2-3

³⁰⁰ Ex. H1-2-1

³⁰¹ Only a very small number of questions were asked about these changes at the hearing: 11Tr.62-63.

³⁰² Ex.L-2.

³⁰³ 11Tr.13.

³⁰⁴ Ex.H3-1-1, Appendix G.

11. Implementation of 2014 Rates

Enbridge proposes that Final 2014 Rates will be implemented in conjunction with the next QRAM Application following the Board's Decision Rate Order. Assuming approval of Enbridge's as-filed Application, the implementation will result in lower distribution rates for the balance of 2014, as well as two Riders to the credit of ratepayers.

The impact of approval of Enbridge's Application will be to reduce 2014 rates. The T-Service Rate Impact for an average residential customer will be a decrease of 1.7%, or about \$9 on an annual basis.³⁰⁵ In addition, approval of the Site Restoration Costs proposal will result in a further 2014 bill reduction of approximately \$27 for an average residential customer.³⁰⁶

Enbridge's current 2014 distribution rates are interim rates, pending the outcome of this proceeding. Final distribution rates for 2014 will be approved within this proceeding. Enbridge proposes to implement the final rates, which under the Company's proposal are lower than the interim 2014 rates, in conjunction with the first QRAM Application following the Board's Decision, and approval of the associated Rate Order.

Assuming that Enbridge's Application is approved as filed, the Company also requests approval of two Riders in conjunction with the implementation of final rates.

Rider E will credit ratepayers with the difference in revenue between interim and final 2014 rates for the period from January 1, 2014 to the date that final rates are implemented.

³⁰⁵ Ex.H1-1-1, p.3.

³⁰⁶ Ex.H1-1-1, p.7.

Rider D is proposed to credit ratepayers with the 2014 portion of the SRC reserve that is to be refunded (\$68.1 million). The unit rates contained within Rider D will apply to customer's monthly consumption and will appear as a separate line item on customers' monthly bills.³⁰⁷

12. Conclusion

Throughout this Argument in Chief, Enbridge has addressed the main items that arose during the 11 day oral hearing. There are, of course, additional items that Enbridge seeks to have approved within the Board decision in this case. The Approvals Requested by Enbridge are set out at Exhibit A1, Tab 3, Schedule 1.³⁰⁸ The Company requests that the Board address all of the Approvals Requested as part of its Decision and/or Rate Order in this case.

Through the Argument in Chief, which addresses each of the nine areas listed in the Introduction, Enbridge has explained how the evidence in this case strongly supports approval of the Customized IR plan by the Board.

As explained in detail, the Customized IR plan is the right plan to suit Enbridge's circumstances over the 2014 to 2018 period. The proposed IR plan has been customized to Enbridge's circumstances, has taken meaningful guidance from a number of sources, such as the RRFE, and is a logical evolution from Enbridge's 1st Generation IR plan. The Customized IR plan meets the Board's objectives for an IR plan. The outcome of the plan is fair and balanced for Enbridge and its ratepayers.

The Customized IR plan contains appropriate mechanisms to incent sustainable efficiency improvements, to protect ratepayers and the Company from benefiting or being burdened by items beyond management's control and to allow for ongoing

³⁰⁷ Details related to Rider D are set out at Ex. H1-1-1, pp. 6-8 and Appendix A.

³⁰⁸ Note that the Approvals Requested were not updated in December 2013, when Enbridge updated its filing to request final approval of Allowed Revenues for all five years of the Customized IR term. Exhibit A2-3-1 should be read as if it had reflected that update (which would change the requests within paras. 3(d) and 6(a), as well as the narrative in para. 1).

reporting and review of the Company's activities. As was the case in the 1st Generation IR plan, a limited number of items (including gas costs and volumes) will be updated each year through rate adjustment proceedings.

Approval of the Customized IR plan includes the 2014 to 2018 Allowed Revenue amounts that result from the application of the Customized IR plan. These Allowed Revenue amounts are reasonable and appropriate. As described herein, the budgets that build up to the annual Allowed Revenue amounts are set at levels that will be difficult for the Company to achieve. The spending forecasts within the budgets have been reduced to their minimum levels through rigorous budgeting processes. The budgets that underlie Allowed Revenue amounts assume that the Company will have to achieve very significant productivity and efficiency improvements totaling more than \$200 million³⁰⁹ over the Customized IR plan term.

Over the five years of the Customized IR plan, the average annual rate increase for residential customers is approximately 2.2%, inclusive of the impact of the GTA Project. Over the five year term, bills for residential customers will increase by about \$59, or an average increase of 1.4%, taking into account the SRC rate rider and the GTA Project.³¹⁰ The bill impact will be mitigated by expected reductions in gas costs once the GTA Project is in service.

As explained, the Customized IR plan enables Enbridge to meet important capital spending needs -- for purposes such as the GTA Project, WAMS and safety and integrity requirements -- and to achieve a fair return on substantial capital investments, with reasonable rate impacts. Further, the implementation of Enbridge's SRC proposal operates so as to reduce both rate and bill impacts. The overall outcome is that

³⁰⁹ See Ex.J1.6, which sets out how the embedded O&M productivity challenge totals around \$172 million, and the embedded capital productivity challenge totals around \$162 million. This does include the additional amounts that will have to be made up to account for the expected variable costs that are not included in the budgets, but which are likely to arise.

³¹⁰ Ex. A2-1-1, p. 7, paras. 14-16 and pp. 39-40, paras. 130-131.

Enbridge is able to deliver significant benefits and value to customers, including the benefits of the GTA Project, at distribution rates that are reasonable and that are further moderated by the rate and bill mitigation effect of the SRC proposal. Enbridge submits that the Customized IR plan produces a fair and balanced outcome for ratepayers and for Enbridge's shareholder.

All of which is respectfully submitted, March 31, 2014.

"Original Signed"

Fred D. Cass
on behalf of Counsel for Enbridge Gas Distribution Inc.