EB-2012-0459

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

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.

WRITTEN SUBMISSIONS OF THE ASSOCIATION OF POWER PRODUCERS OF ONTARIO

April 22, 2014

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DELIVERED: APRIL 22, 2014

I. INTRODUCTION

1. The Association of Power Producers of Ontario ("**APPrO**") submits these written submissions in respect of an application by Enbridge Gas Distribution Inc. ("**Enbridge**") with the Ontario Energy Board (the "**Board**") under Section 36 of the *Ontario Energy Board Act, 1998* (the "**Act**") for an Order or Orders approving or fixing rates for the sale, distribution, transmission and storage of gas commencing January 1, 2014 (Board File No. EB-2012-0459) (the "**Application**").

2. APPrO's principal area of concern in the Application is Enbridge's proposed cost allocation methodology (Issue C30). APPrO first raised this concern in Enbridge's application for leave to construct its GTA reinforcement project (the "**GTA Reinforcement Project**") in Board File No. EB-2012-0451. After a close examination of the need for both Segments A and B of the GTA Reinforcement Project, APPrO expressed its support for the project *contingent on the costs of adding the capacity being borne by those parties that are benefiting from the capacity that is being added*.[1]

3. In this Application, Enbridge has forecasted a 31% rate increase for Rate 125 customers over the 5 year term.[2] A substantial portion of the projected rate increase arises from several major reinforcement projects for the Enbridge extra high pressure ("**XHP**")

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[1] APPrO Argument in EB-2012-0451 dated November 15, 2013 at paras. 41-43.
[2] Exhibits H1-1-1 page 3, H3-1-1 Appendix A, H3-1-2 Appendix A.

system, including without limitation the Segment B portion[3] of the $686 million[4] GTA Reinforcement Project and the $51 million Ottawa Reinforcement Project.[5] These projects are being constructed primarily to accommodate the capacity requirements of up to 20 years[6] of growth from general service customers (although APPrO acknowledges that Segment B has several intended functions, including allowing the shift of current system supplies from Victoria Square to Parkway, and allowing a pressure reduction of the Don Valley Line).[7]

4. As the representative of the gas fired electricity generators in Enbridge's franchise, including Enbridge's largest customers, the five (5) very large natural gas consumers served by Enbridge under the Rate 125 customer class, APPrO is very concerned that Enbridge's proposed cost allocation methodology significantly over allocates costs associated with the XHP system to Rate 125 customers.

5. Specifically, APPrO is concerned that:

> (1) Enbridge is proposing a cost allocation methodology that will, if accepted by the Board without change, allocate costs associated with Enbridge's XHP assets which, by Enbridge's own admission, are neither being used to serve nor are theoretically capable of serving Rate 125 customers (hereinafter referred to as the "**Over-Allocation Issue**"); and
>
> (2) Enbridge is proposing a cost allocation methodology that will, if accepted by the Board without change, require Rate 125 customers to pay for excess capacity in the system twice - first through an economic feasibility test and again through its cost allocation for major reinforcement projects (hereinafter referred to as the "**Double Counting Issue**").

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3 APPrO understands and agrees with Enbridge's proposal for the allocation of costs associated with Segment A of the GTA Reinforcement Project as described in Exhibit K11.1 Page 3.
4 Transcript Volume 11 page 57.
5 Transcript Volume 5 page 43.
6 Transcript Volume 6 page 33.
7 Technical Conference Transcript dated January 20, 2014 at pages 82-82, and Exhibit L-2-1 at page 8.

6. APPrO's two concerns were first raised in the expert report of Mr. John Todd and Mr. Mike Roger (Exhibit L, Tab 2, Schedule 1). APPrO's concerns remain regardless of the form of incentive ratemaking used to establish rates for Enbridge.

7. The impact of the Over-Allocation Issue on Rate 125 customers is material to all of the customers in this class. Specifically, Enbridge's proposed revenue requirement allocated to all Rate 125 customers is **35%** higher than it should be in the test year if Enbridge adhered to the principle of cost causality and only allocated to the Rate 125 customer class those costs associated with XHP assets with the minimum nominal diameter Enbridge actually uses to service those customers (i.e. 12 inches and above).[8]

8. APPrO is unable to calculate the impact of the Double Counting Issue on Rate 125 customers at this time. In the interrogatory process, APPrO had requested a working copy of the cost allocation model, but Enbridge declined to provide it.[9] As a result, Elenchus was unable to further study this issue in detail to develop an equitable solution for all parties and APPrO is unable to quantify the impact of the Double Counting Issue.

9. APPrO's two concerns are separate and distinct. To-date, in responding to these concerns Enbridge has chosen to lump them together. APPrO is concerned that Enbridge's approach results in confusion as between the two issues. APPrO invites Enbridge to dispel this concern in its reply submissions by being crystal clear how its arguments relate to each of the two concerns raised by APPrO.

10. APPrO's two concerns arise at a time when a variety of pressures are causing increases in the rates paid by electricity consumers. Many of APPrO's members, including Rate 125 customers, are under contract with the Ontario Power Authority (the "**OPA**") for the generation of electricity. While the details of the particular contractual arrangements vary, and are confidential as between the contracting counterparties, APPrO agrees with

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8 The 35% is calculated based on Enbridge's response to TCU 3.19 which shows a $2.59 million reduction in revenue requirement in the test year if Enbridge did not allocate pipe 8 inches and below to Rate 125 customers. Taking $2.59 million and dividing it by $7.37 million (the total revenue requirement in the test year if Enbridge did not allocate pipe 8 inches and below to Rate 125 customers) = 35.14%.

9 Exhibit I.C30.EGDI.APPrO.10d)

the OPA that increases in rates, particularly Rate 125, may result in increases to the price of electricity for Ontario ratepayers.[10]

11. APPrO is willing to accept that prior to this proceeding Enbridge may not have undertaken a detailed assessment of its cost allocation methodology to identify the Over-Allocation Issue or the Double Counting Issue. APPrO is also willing to accept that this Board may have previously approved Enbridge's cost allocation methodology without being aware that these problems existed.

12. However, Enbridge has now, after having these two issues brought to its attention through the expert testimony of Mr. Todd and Mr. Roger, indicated that it accepts neither of the experts' recommendations.[11] It is worth noting, because it is counterintuitive, that Enbridge's argument for refusal can be found at page 3 of its evidence-in-chief for Panel 14 (Exhibit K11.1) rather than in Enbridge's argument-in-chief.

13. Enbridge's stated grounds for refusal of the two Elenchus recommendations are found in Exhibit K11.1 and are as follows:

> *"The Company's rates are designed to recover the test year revenue requirement of an integrated system. The use of postage stamp cost allocation and rate making is supported by the costing of each service at the customer class average. This approach to setting rates does not differentiate between specific investments or the mix of investment vintages. Enbridge's Board-approved cost allocation methodology appropriately and sufficiently determines the relative cost differences between customer classes.*
>
> *In the Company's view it would be inappropriate to deviate from the established approach. If changes were to be made to Enbridge's Board-approved cost allocation methodology, then the Company's view is that the proposed changes would need to be evaluated on a comprehensive basis rather than only on the basis of treatment of specific investments. The Company is of this view because, as pointed out earlier, some of APPrO's scenarios (requested through interrogatories) resulted in more*

[10] OPA letter of comment dated April 9, 2014.
[11] Exhibit K11.1 at pg. 3.

costs being allocated to Rate 125 customers and some resulted in less costs being allocated to Rate 125 customers."

14. Without the benefit of having seen these more comprehensive submissions from APPrO, Board staff agreed with Enbridge in their submissions dated April 15, 2014, noting:

> *"Staff's view is that the Elenchus proposals should be rejected. The proposal runs contrary to accepted principles of postage-stamp ratemaking for Enbridge. Board staff also agrees with Enbridge that if the Board were inclined to further examine this issue, it should do so on a broader basis, rather than only on the basis of treatment of specific investments related to a specific class of customer."*

15. In response, and in defence of the Elenchus recommendations, APPrO submits that:

(a) Both Enbridge and staff have failed to demonstrate how the Elenchus recommendations are contrary to the "use of postage stamp cost allocation and rate making, as supported by the costing of each service at the customer class average".

(b) The concept of postage stamp rates relates to the way in which rate classes are defined. The postage stamp rate concept is one aspect of the sixth of Bonbright's ten "attributes of a sound rate structure"[12] which pertains to fairness in stating that in a sound rate structure "equals [are] treated equally" and "unequals are treated unequally." The concept of postage stamp rates requires that similar customers (i.e. equals) are placed in a single rate class (i.e. Rate 125 consists of "equals" – currently all of the customers in this class are gas-fired generators) and "unequals" are in different rate classes. Furthermore, all customers within a class are treated equally. As Mr. Kacicnik noted the 'postage-stamp ratemaking'

[12] Bonbright, James C., Albert L. Danielsen and David R. Kamerschen, Principles of Public Utility Rates, Second Edition (1988), Public Utilities Reports, Inc. pages 383-384.

approach means that no matter the customer's location, be it Ottawa or Niagara or Toronto, each class of customer will have the same rate.[13]

(c) The Over-Allocation Issue and the Double Counting Issue are not unique to a specific customer, or a subset of customers within a customer class. Rather, the issues identified in the Elenchus report impact the entire Rate 125 customer class across the Province. As a result, the Elenchus recommendations are entirely consistent with use of postage stamp cost allocation and rate making across the province. Rate 125 customers would continue to be allocated costs and rates established on a class wide, and province wide, basis.

(d) Mr. Kacicnik also explains that 'postage-stamp ratemaking' means that all customers share in the mix of investment vintages.[14] It is here that Enbridge (and, unfortunately, Board staff) falls into the trap of lumping the two issues together. APPrO would strongly caution the Board against doing the same.

(e) The fact is that the Elenchus recommendation to address the Over-Allocation Issue does not deviate from the principle that all customers must share in the mix of investment vintages. The issue is not old vs. new. The issue is a distinction between higher capacity (larger diameter) vs. lower capacity (smaller diameter) mains. In this regard, the following submissions relate to the Over-Allocation Issue:

(i) Enbridge already distinguishes between high capacity (TP Capacity) and low capacity (HP and LP Capacity) assets in its cost allocation model. Enbridge admits that this distinction is driven by cost causality principles, and is consistent with the use of postage stamp cost allocation and ratemaking.[15] Elenchus' first recommendation is an extension of the same cost causality principle. Enbridge's current cost allocation methodology

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13 Transcript Volume 11 at pg. 4, line 15-21.
14 Transcript Volume 11 at pg. 4, line 15-21.
15 Transcript Volume 11 at pg. 14, line 1 to pg. 15, line 1.

simply doesn't go far enough to ensure cost causality is maintained for its largest customers, the Rate 125 customer class. It is in this context that Elenchus recommends that Enbridge should go further to distinguish between high and low capacity XHP assets so that these assets can be allocated in a manner that better reflects cost causality principles.

(ii) Enbridge already makes reference to the nominal pipe diameter of XHP assets in its cost allocation methodology when determining how much of the costs in its uniform system of accounts should be allocated to TP Capacity.[16] Given this practical reality, the use of nominal pipe diameter to further distinguish between high and low capacity XHP assets in a manner that better reflects cost causality is entirely appropriate.

(iii) Enbridge admits that it is allocating costs associated with XHP assets with a nominal pipe diameter ranging from 1.5 inches to 8 inches to its current Rate 125 customers even though we know that no current Rate 125 customer caused those costs.[17] Rather, Enbridge acknowledges that the minimum nominal pipe diameter being used to service any existing Rate 125 customer is 12 inches.[18]

(iv) We know that Enbridge is not forecasting any new Rate 125 customers at any time during the 5-year term of its Application.[19] In this context, it is unclear why speculative costs should be allocated to existing Rate 125 customers based on a hypothetical future customer – particularly when no such future customer is reasonably contemplated.

(v) The Board has an analysis of the rate impacts of not allocating assets with a nominal pipe diameter of 8 inches and below to Rate 125 in the Enbridge

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16 Transcript Volume 11 at pg. 15, line 12 to line 20.
17 Transcript Volume 11, Page 15, Line 2 to Page 16, Line 20.
18 Transcript Volume 11, Page 16, Line 21 to Page 18, Line 5.
19 *Ibid*. at Page 28, Lines 19-26.

response to TCU 3.19. Enbridge acknowledged during questioning at the technical conference that a proposed reallocation of $1 million will barely have any impact on Rates 1 and 6.[20] The change better reflects cost causality principles, is material to the Rate 125 customer class, but is *de minimis* for the other customer classes.

(f) Enbridge has also failed to demonstrate how Elenchus' second recommendation, in respect of the Double Counting Issue, violates the principle of postage stamp ratemaking. To be clear - Elenchus gave two options in its second recommendation.[21] It might be that Enbridge *decided* it would violate postage stamp ratemaking principles when applying *its own interpretation to and implementation of* Elenchus' second recommendation. Enbridge has not provided a sufficient level of detail about how it has interpreted or implemented Elenchus' second recommendation in the evidentiary record in this proceeding. As a result, it is impossible for the Board to assess Enbridge's assertion in the absence of more detailed evidence. This circumstance has shaped APPrO's recommendation in respect of the Double Counting Issue.

(g) The Elenchus recommendations should not be refused simply because they were not discovered as part of a "comprehensive" review of Enbridge's cost allocation methodology. Enbridge did not propose a comprehensive review of its cost allocation methodology in its Application, and presumably any such review would not occur until the end of the current 5-year term of its Application. In the interim, Enbridge is proposing a cost allocation method that fails to address the Over-Allocation Issue and the Double Counting Issue to the detriment of all existing Rate 125 customers. In this context, Elenchus' comments ring true that "subject to issues of availability of data and practicality, there is a predisposition

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20 Technical Conference Transcript dated January 20, 2014, Page 78, Line 17 to Page 79, Line 3.

21 Specifically, Elenchus recommends at pg. ii of their report that "[i]n order to avoid Rate 125 customers paying in two ways for the excess capacity required in the Enbridge system to accommodate future growth efficiently, Enbridge should be directed either to amend its economic feasibility test as it applies to Rate 125 customers or to modify its cost allocation methodology so that Rate 125 customers are not required to pay for excess capacity in the system in two ways."

to adopt refinements that result in an allocation that better reflects cost causality."[22]

(h) The mere fact that APPrO asked a variety of questions during the interrogatory process with an aim at better understanding the proposed cost allocation methodology should not, in itself, constitute grounds to deny the Elenchus recommendations. Enbridge agreed in cross-examination that the only mechanism APPrO had available to understand the Enbridge cost allocation methodology was to ask questions in the discovery process.[23] Based on Enbridge's interrogatory responses, Elenchus' conclusion was that, aside from the Over-Allocation Issue and the Double Counting Issue, they "agree with the basic approach utilized by Enbridge."[24] This is why APPrO is not recommending any other changes to Enbridge's cost allocation model. Put another way, when both Enbridge and APPrO's independent experts agree, it would have been a waste of resources for APPrO to press for further changes to Enbridge's cost allocation methodology simply because questions were asked during the interrogatory process.

16. With a defense of the Elenchus recommendations complete, APPrO will describe its position for the Board. APPrO has organized its submissions into two sections. The first addresses APPrO's two recommendations in respect of the Enbridge cost allocation methodology (issue C30). The second includes APPrO's concerns with the balance of the Application (all other issues).

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22 Exhibit L, Tab 2, Schedule 1, Page 18 of the Exhibit (page 11 of the report), Lines 9-11.
23 Transcript Volume 11, Page 12, Lines 19-25.
24 Exhibit L, Tab 2, Schedule 1, Page 18, line 5.

II. CONCERNS WITH THE ENBRIDGE COST ALLOCATION PROPOSAL

Issue C30 ***Is Enbridge's utility Cost Allocation Study, including the methodologies and judgments used and the proposed application of that study with respect to 2014 Fiscal Year rates, appropriate***

A. Summary of APPrO's Concerns

17. APPrO is very concerned that Enbridge's proposed cost allocation methodology significantly over allocates costs associated with the XHP system to Rate 125 customers. Specifically, APPrO is concerned that:

> (1) Enbridge is proposing a cost allocation methodology that will, if accepted by the Board without change, allocate costs associated with Enbridge's XHP assets which, by Enbridge's own admission, are neither being used to serve nor are theoretically capable of serving Rate 125 customers (referred to above the Over-Allocation Issue); and
>
> (2) Enbridge is proposing a cost allocation methodology that will, if accepted by the Board without change, require Rate 125 customers to pay for excess capacity in the system twice - first through an economic feasibility test and again through its cost allocation for major reinforcement projects (referred to above as the Double Counting Issue).

B. Summary of APPrO's Recommendations

18. With due consideration of the Enbridge evidence and the Elenchus recommendations, APPrO submits that:

APPrO Proposal 1 - Addressing the Over-Allocation Issues

(a) The Board should order Enbridge to immediately address the Over-Allocation Issue by modifying its cost allocation methodology commencing in 2014 to allocate to Rate 125 customers only the revenue requirement associated with those XHP pipe sizes that are being used to provide service to the Rate 125 customer class.

(b) At a bare minimum, this would mean not allocating costs associated with XHP pipes of diameters 4" and less to Rate 125, which pipes Enbridge admits are not even theoretically capable of serving any Rate 125 customers.[25]

(c) In addition, Enbridge has been clear that 12" is the smallest pipe diameter used to service this rate class.[26] Enbridge has also been clear that no new Rate 125 customers are forecasted to come on-line during the term of the Application. In order to be consistent with cost causality principles used in cost allocation, only XHP pipe sizes 12" and larger as well as any directly related assets (meter and regulation stations) and O&M costs, should be allocated to the Rate 125 customer class. Similarly, those XHP pipe sizes, related assets and O&M cost for pipe sizes less than 12" would no longer be allocated to Rate 125, since those assets are not used to serve any Rate 125 customers.

(d) The revenue requirement for Rate 125 customers resulting from not allocating costs associated with XHP mains less than 12 inch diameters is found in the last column of Table 1 at TCU3.19. The associated rate impacts to Rate 125 are found in the last column of Table 2 at TCU3.19.

APPrO Proposal 2 – Further Study of the Double Counting Issue

(e) The Board should order Enbridge to conduct further study of the Double Counting Issue, with a view to providing to the Board and the intervenors in this proceeding a report in 2015, in time for its 2016 rate application, that includes an assessment of various proposed solutions to remedy the Double Counting Issue in a fair and equitable manner for all customers, together with Enbridge's recommended solution to address the Double Counting Issue. With the benefit of this additional analysis, the Board and the parties can engage in a more informed discussion about how to best address the Double Counting Issue.

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25 Enbridge response to APPrO Interrogatory 10(b) (Exhibit I.C30.EGDI.APPrO.10 Page 2 of 4).
26 January 20, 2014 Technical Conference Transcript page 75-76

C. Background

19. On January 30, 2014, the Board issued its Decision and Order granting, *inter alia*, Enbridge leave to construct its GTA reinforcement project (Board File No. EB-2012-0451). At Page 49 of its Decision and Order, the Board stated (emphasis added):

> *"APPrO opposed the rate impact on unbundled distribution customers and argued that the costs of the GTA Project should be borne mostly by bundled and transportation customers. APPrO indicated that it intended to address this concern in an upcoming rate proceeding, likely Enbridge's IRM application. APPrO's argument is similar to the submission Kitchener made on Union's Parkway West Project. Like Kitchener,* ***APPrO raises considerations which require an examination of cost allocation principles which is beyond the scope of this proceeding. Cost allocation issues are generally reviewed in cost of service rebasing hearings, and APPrO has indicated that it intends to raise the issue in a future rates proceeding. The Board need not make a determination on this issue at this time****."*

20. APPrO's primary focus in the Application has, unsurprisingly, been on Enbridge's cost allocation proposal. APPrO's concern has been clearly stated throughout the proceeding.

21. On September 9, 2013, APPrO filed an expert plan detailing its intent to engage an independent expert to review the Application and to give evidence in respect of Enbridge's cost allocation proposal (the "**Expert Plan**"). No party objected to APPrO's Expert Plan.

22. APPrO undertook a competitive RFP process to select a cost allocation expert, and on October 3, 2013 APPrO notified the Board that it had chosen Mr. John Todd and Mr. Mike Roger of Elenchus Research Associates Inc. as its experts to "assess Enbridge's current cost allocation methodology and, if possible to develop a more equitable cost allocation methodology."[27] In addition to being eminently qualified, the Elenchus proposal represented the most cost-effective proposal received by APPrO in response to the competitive RFP process.

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[27] APPrO Expert Plan dated September 9, 2013, reproduced in Exhibit K11.1 at page 9.

23. Mr. Todd and Mr. Roger were required to, and did, comply with the Board's Rule 13A of the Rules of Practice and Procedure (the "**Rules**"), including but not limited to Rule 13A.02 regarding independence.[28] This was a requirement that was set out in the APPrO RFP,[29] and was fundamental to the relationship between APPrO and the independent experts. APPrO will make reference to the work of Mr. Todd and Mr. Roger throughout these submissions.

D. Principles Based Recommendations – Postage Stamp Rate Making and Cost Causality

24. In making its two recommendations, APPrO has been informed by its independent cost allocation experts and has made it a top priority to put forth recommendations that are principles based and practical. The APPrO recommendations are entirely consistent with the principles of cost causality and postage stamp rate making.

25. The concept of postage stamp rates relates to the way in which rate classes are defined. The postage stamp rate concept is one aspect of the sixth of Bonbright's ten "attributes of a sound rate structure"[30] which pertains to fairness in stating that in a sound rate structure "equals [are] treated equally" and "unequals are treated unequally".

26. The concept of postage stamp rates requires that similar customers (i.e., equals) are placed in a single rate class (i.e., Rate 125 consists of "equals" - currently all of the customers in this class are gas-fired generators) and "unequals" are in different rate classes. Furthermore, all customers within a class are treated equally. As Mr. Kacicnik described the 'postage-stamp ratemaking' approach means that no matter the customer's location, be it Ottawa or Niagara or Toronto, each class of customer will have the same rate. This principle is adhered to by the APPrO proposal.

27. Mr. Kacicnik then goes on to state that postage-stamp ratemaking also means that all services have their costs calculated on an average cost basis. All customers therefore

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28 Transcript dated March 25, 2014 Volume 11 in EB-2012-0459 at pg. 77.

29 APPrO Expert Plan dated September 9, 2013, Appendix A – RFP at pg. 3 and at Attachment 1.

30 Bonbright, James C., Albert L. Danielsen and David R. Kamerschen. Principles of Public Utility Rates, Second Edition (1988), Public Utilities Reports, Inc. pages 383-384.

share in the mix of investment vintages, no matter how old the pipes, or when they were placed into service. Again, the APPrO proposal is also consistent with this concept of postage stamp rate-making. It does not identify assets to be allocated to Rate 125 based on the age, location or any other inappropriate basis. The sole consideration in the identification of assets to be allocated to Rate 125 is the principle of cost causality. Cost causality is principle that lies at the heart of cost allocation.

28. Enbridge seems to be of the opinion that postage-stamp principles means sacrificing cost causality when properly apportioning the utility's assets and expenses amongst its customer classes. If the Board would be of the same opinion, then for the sake of postage stamp principles all customers would pay the same rates, regardless of what assets and expenses are incurred by utilities to supply their customers.

29. This is clearly not the case.

30. The costs associated with all Enbridge mains that are part of the distribution system are not allocated to all customer classes. An attempt is made by Enbridge to identify which customer classes are served by each category of pipe and the associated costs are allocated only to those customer served by that category of pipe - i.e., it is allocated to those customer classes that make it necessary, or cause, the category of pipe to be installed.

31. For example, referring to Exhibit G2, Tab 4, Schedule 1, distribution mains are classified into three classes of assets - Transmission Pressure (TP) Capacity, High Pressure (HP) Capacity and Low Pressure (LP) Capacity. The allocation of the rate base associated with these three classes of assets is shown as Exhibit G2, Tab 5, Schedule 1, with the allocators shown at Exhibit G2, Tab 6, Schedule 3, page 1 (Allocation Factors) and page 2 (Allocation Percentages). Notably:

(a) Capacity TP is allocated to all classes since the gas delivered to customers in all rate classes passes through TP pipe.

(b) Capacity HP and LP are not allocated to those classes that take gas directly off the TP system.

32. At the present time, all XHP assets are treated as assets that are classified as TP Capacity. The issue is whether this treatment is consistent with the principle of cost causality. If it is not, any mischaracterization should be corrected at this time. Changes should not be deferred until a future, unspecified date. Any misallocation results in inequitable treatment of a class of customers and should be corrected when identified.

33. The concept underlying Enbridge's classification of mains into three categories is that different classes of mains are used in different ways and not all mains are used by, hence costs are not caused by, all customer classes. In cross-examination, Mr. Kacicnik acknowledged this - agreeing that Enbridge's classification of mains into three categories was intended to better reflect cost causality principles and was, in Enbridge's view, consistent with the use of postage-stamp ratemaking.[31]

34. The point made originally by Elenchus, and now being made by APPrO, is that just as gas flows from higher pressure mains to lower pressure mains as it moves from the TCPL transmission line to Enbridge's end-use customers, so too does it move from larger diameter pipe to smaller diameter pipe. Both pressure and pipe diameter contribute to the capacity of a pipe and the capacity (deliverability) declines as the pressure and/or pipe diameter decrease.

35. The issue the Board is being asked to determine is at what point does pipe cease being usable to deliver gas to Rate 125 customers. If a class of pipe cannot practically be used to deliver gas to Rate 125 customers, then they should not share in the cost of the pipe.

36. There is no magic in defining the usefulness of pipe for delivering gas to Rate 125 customers in terms of the pressure in the pipe alone (as Enbridge proposes). Pipe diameter is also relevant. In essence, as gas moves downstream toward the customer,

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31 Transcript Volume 11, Page 14, Line 13 to Page 15, Line 1.

Enbridge can reduce either the pipe diameter or the pressure as the capacity/deliverability requirements decline. The choice between a smaller diameter pipe at higher pressure or a larger diameter pipe at lower pressure is an economic one. In either case, the key factor for the usefulness of the pipe for delivering gas to Rate 125 customers is not its pressure, but its capacity, which is dependent on both pressure and pipe diameter.

37. The cut-off point for mains that are allocated to Rate 125 customers should be whether they have sufficient capacity to deliver the gas volumes required by Rate 125 customers. Any combination of small pipe size and low pressure that results in inadequate capacity/deliverability cannot be characterized as pipe that is "caused" by this class. If there is no causal relationship, there should be no allocated costs.

38. By way of example, APPrO notes that the Board, in providing direction to electricity distributors on how to allocate assets and expenses to their customers in a cost allocation study used to establish cost based rates, in Proceeding EB-2005-0317, dated September 29, 2006, in section 6.2, page 34, explicitly directs electricity distributors to split assets and expenses into three groups: Bulk, Primary and Secondary. More specifically, the Board in section 6.2.1, Introduction, states that:

> *The objective of breaking out accounts into sub-accounts is to better reflect the costs ultimately associated with specific assets according to the role of these assets in the distribution system, i.e., their function. This in turn will affect the share of costs allocated to the various rate classifications.*

39. It is clear that the Board endorses cost causality in establishing customer rates and does not consider this to be a deviation from postage stamp principles. Electricity distributors charge their customers Board-approved rates that are postage stamp, that is, all customers in the same customer class pay the same distribution rates, but this does not mean that the rates they pay are not based on cost causality. On the contrary, to the extent that electricity distributors can split their assets and expenses based on cost causality, the Board directs electricity distributors to do so in their cost allocation studies.

40. Electricity distributors, in their cost allocation studies filed with the Board in support of their distribution rates, split their distribution assets and expenses into Primary and Secondary and Hydro One Distribution splits them into Bulk, (called Sub-transmission), Primary and Secondary.[32]

41. APPrO's recommendations do not violate the postage stamp principle at all. All customers within the same customer class still pay the same rates. Rather, APPrO's recommendations are based on cost-causality and result in an improvement to Enbridge's cost allocation methodology.

E. Rate 125 History – The Economic Feasibility Test and Billing Contract Demand

42. New Rate 125 customers undergo a feasibility test to ensure that the new facilities added to service these customers meet a profitability index (PI) of at least 1.0 or pay a contribution in aid of construction (CIAC). These projects therefore generate the required revenue over the term of the contract to meet the minimum feasibility requirements.

43. Enbridge also offers a by-pass competitive rate for customers that could directly connect to upstream transmission systems. The intention is that those customers that could economically bypass the utility would pay demand charges at a level equal to the Billing Contract Demand (BCD) rather that the Contract Demand (CD). In these situations, the BCD is set at a level that results in the profitability index of the project being equal to 1.0. The BCD demand charge rate paid by such customers is the same as the demand charge rate paid by any Rate 125 customer. The Rate 125 demand charges only apply to the lower BCD level rather than the CD level. All of the additional pipeline facilities are sized and constructed to meet the full peak day demand of the customer. It may be helpful to review some history of the history of Rate 125 and the resulting BCD concept:

    (a) Excerpts from the Background and Economic Feasibility sections of the EB-2005-0539 decision and more specifically the BCD:

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32 EB-2007-0681, Exhibit G2, Tab 1, Schedule 1, page 2, line 23 to page 3, line 9.

"In 2002, Sithe Canadian Pipelines [SIC] Ltd. ("SCP") filed an application for leave to construct a pipeline to connect the Goreway Station to the gas system operated by TCPL. At about the same time Enbridge filed a competing application to supply the Goreway Station. Both applications were adjourned in early 2003 and subsequently withdrawn on January 30, 2006 and January 26, 2006, respectively. The current application by Enbridge to build the proposed pipeline results from negotiations between Enbridge and Sithe Global."[33]

(b) The Board went on to say:

"The economic feasibility of the project was calculated by discounting incremental cash flows over the 20 year customer revenue horizon. The revenues were based on an agreement between Enbridge and Sithe Global to set a contract demand ("CD") for billing purposes (the "billing contract demand" or "billing CD") under Rate 125 at a level that fully recovers all of Enbridge's incremental costs of construction and operation. The final billing CD will be set six months after construction of the project has been completed to ensure that the revenues from the pipeline recover all the costs associated with the project. For the purpose of the feasibility analysis, Enbridge has set a billing contract demand at 2,980,431 m3 per day. The results of this analysis indicate that the project has a profitability index ("PI") of 1.0 or a net present value ("NPV") of $0 over the 20 year period."[34]

(c) The Board also noted that while the formal PI of this project was 1.0 there were additional system benefits:

"Enbridge expects to earn additional revenues from the proposed pipeline with the sale of overrun transportation (i.e. volumes transported above the billing CD) service to Sithe Global in excess of the billing contract demand. The additional revenues were not included in the feasibility analysis. Reflecting these potential revenues, the proposed project's PI was estimated to be as high as 1.4."[35]

(d) Mr. Todd in his testimony[36] describes that Rate 125 and the BCD was <u>*the deal*</u> between new large volume customers and Enbridge and other ratepayers to reduce

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33 Excerpt from the Leave to Construct Decision EB-2005-0539 page 2
34 Excerpt from the Leave to Construct Decision EB-2005-0539 page 7
35 Excerpt from the Leave to Construct Decision EB-2005-0539 page 7
36 Transcript Volume 11 page 92

the incentive for these large volume customers to by-pass the utility. Goreway had in fact filed its bypass application and based on the negotiations with Enbridge (*the deal*) it agreed to withdraw its application as noted in the EB-2005-0539 decision.

(e) The additional revenues referenced in the EB-2005-0539 decision above, that Enbridge expected to receive were not included in the feasibility of the project and would accrue either directly to Enbridge or to other ratepayers. These types of secondary benefits are beneficial to the system and create part of *the deal* for Enbridge and other ratepayers.

(f) The Over-Allocation Issue and the Double Counting Issue both have the effect of increasing, rather than decreasing, the incentive for large volume customers to by-pass Enbridge – which is contrary to the very spirit of *the deal*.

F. APPrO Proposal 1 - Changing the Allocation of Certain XHP Pipe Sizes for Rate 125

44. In the independent expert report filed at Exhibit L, Tab 2, Schedule 1, Elenchus' first recommendation was:

> *"First, the XHP function should be further broken down into those assets and expenses that can reasonably serve rate 125 customers and the rest of the XHP assets that cannot serve Rate 125 customers. In the Allocation step of the CAM, Enbridge should allocate to rate 125 customers only those XHP assets and expenses that can be used to reasonably supply services to them as well as other customers who can be served by those facilities."*[37]

45. APPrO has carefully considered the evidence of Enbridge and this recommendation and supports Elenchus' recommendation and asks the Board to direct Enbridge to adopt this recommendation and only allocate to Rate 125 customers those XHP assets and expenses that can be used to reasonably supply services to Rate 125.

[37] Exhibit L, Tab 2, Schedule 1, page 16

46. The issue at hand is what are the XHP assets that reasonably serve Rate 125?

47. Enbridge has been clear that XHP pipe sizes 4” and below are not even theoretically capable of serving any Rate 125 customers,[38] 6” and 8” pipe may theoretically be capable of serving an assumed new Rate 125 customer at the class minimum,[39] and 12” XHP pipe is the smallest pipe size actually being used to serve any existing Rate 125 customers.[40]

48. While 6” and 8” XHP pipe may be able to theoretically serve a hypothetical, smallest eligible, Rate 125 customer:

(a) Enbridge does not have the capacity in 6” and 8” XHP pipes to supply the smallest eligible Rate 125 customer:

> *“The amount of installed capacity on our system wouldn’t support a Rate 125 customer anywhere throughout our system.”*[41]

(b) It would not be Enbridge’s plan to connect a future Rate 125 customer to a 6” or 8” XHP pipe:

> *“MR. KACICNIK: Just to clarify it, it would be very unlikely that we would be attaching a new Rate 125 customer to an existing 6- or 8-inch system that’s operating at these kinds of pressures.”*[42]

(c) Rate 125 customers tend to have loads substantially greater than the minimum eligible load to qualify for Rate 125[43] so it is highly unlikely that a new 6” or 8” line would be capable of serving such a customer even if a new Rate 125 customer were to request service in the future.

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38 Exhibit I.C30.EGDI.APPrO.10b)
39 TCU3.18
40 Transcript Volume 11 pages 16-17
41 Transcript Volume 5 page 35
42 Transcript Volume 11 page 27
43 Exhibit L-2 page 13

(d) Mr. Todd, in his testimony, indicated that there was no bright line between what XHP pipe sizes should and should not be allocated to Rate 125.[44]

(e) Mr. Todd, however goes on to say that no pipe smaller than 12” is actually being used to service Rate 125 customers, and using the used and useful concept, it would be inappropriate to allocate any pipe sizes less than 12” to Rate 125.[45]

(f) Enbridge has indicated that no new Rate 125 customers are forecasted at any time during the term of the Customized IR plan.[46]

(g) Mr. Todd also indicated that it was his understanding that there would be no more Rate 125 customers coming on the system.[47]

49. In summary:

(a) 12” XHP pipe is the smallest pipe currently serving any Rate 125 customers,

(b) No new Rate 125 customers are being forecast in the foreseeable future,

(c) Enbridge would not use its existing 6” and 8” XHP pipes to service a new customer even if one were to come on line, and

(d) Rate 125 customers tend to have loads multiple times greater than the minimum eligibility requirements for Rate 125, raising doubt about the suitability of a new 6” and 8” XHP pipe, even if a new Rate 125 customer were to come on line in the future.

50. Therefore, it is APPrO’s position that there is overwhelming evidence to rationally support the position that only XHP pipe 12” and above should be allocated to Rate 125.

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44 Transcript Volume 11 page 101
45 Transcript Volume 11 page 100
46 Transcript Volume 11 page 28
47 Transcript Volume 11 page 112

51. Enbridge, in its direct evidence suggested:

> *"In the Company's view it would be inappropriate to deviate from the established approach. If changes were to be made to Enbridge's Board-approved cost allocation methodology, then the Company's view is that the proposed changes would need to be evaluated on a comprehensive basis rather than only on the basis of treatment of specific investments."*[48]

52. APPrO respectfully disagrees that it is necessary to make comprehensive changes to the cost allocation methodology at this time. Enbridge had ample opportunity in this proceeding to make such changes if it believed such changes were required and chose not to do so. APPrO will return to this issue again in its comments on timing below.

53. The cost allocation changes being recommended by Elenchus and APPrO are minor modifications, the impacts of which have already been calculated by Enbridge[49] and Enbridge has indicated that they can readily implement these as part of their 2014 rate order.[50] Mr. Todd, with his over 35 years of experience, indicated that the normal approach is to make cost allocation changes on an incremental basis without the need for major reviews.[51] Further similar changes were often initiated by Enbridge[52] and brought forward to the Board for approval without a comprehensive review.

54. Furthermore Mr. Roger in his extensive experience referenced a very parallel precedent where Hydro One distribution assets were similarly sub-divided based on customer usage, and approved by the Board.[53]

55. APPrO is proposing that only the cost of 12" XHP pipe and above be allocated to Rate 125. The revenue requirement that should be allocated to Rate 125 is shown in the third column in the Table below.[54]

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48 Exhibit K11.1 page 4
49 TCU3.19
50 Transcript Volume 11 page 18
51 Transcript Volume 11 page 97-98
52 Ibid.
53 Transcript Volume 11 page 129-130

Impact on Revenue Requirement to Rate125 of Allocating Only 12" XHP and Above to This Rate Class ($million)

(1) Year	(2) As Proposed	(3) Excluding ≤ 8"	(4) Difference
2014	$ 9.96	$ 7.37	$ 2.59
2015	$ 10.53	$ 7.83	$ 2.70
2016	$ 13.15	$ 10.32	$ 2.83
2017	$ 13.65	$ 10.65	$ 3.00
2018	$ 14.20	$ 11.01	$ 3.19

56. From the above table, APPrO notes that even with these cost shifts the revenue requirement for Rate 125 customers in 2018 (after the GTA project is included in rate base), is still substantially higher than the current revenue requirement.

57. It is worth noting that Elenchus was unable to calculate the rate impact to other rate classes of this proposal as it did not have a working copy of the Enbridge cost allocation model,[55] nor did Enbridge provide this information when it was requested.[56]

58. Enbridge stated in response to APPrO's Interrogatory 10, part c iii and iv that the impact on other customer classes of excluding XHP mains of 4 inches in diameter and below from being allocated to Rate 125 customers "…would be minor."[57] This impact was $0.94 million ($9.02 - $9.96). [58]

59. It is reasonable to expect then that the impact of excluding XHP mains of 8 inches in diameter and below from being allocated to Rate 125 customers $2.59 million

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54 Summarized from TCU3.19 page 1. [Note Enbridge does not use 10"XHP pipe (Ex I.C30.EGDI.APPrO10.c)), therefore the impact of allocating only the costs of 12" and above is the same as excluding the costs of 8" and below.]
55 Exhibit I.C30.EGDI.APPrO.10d)
56 Exhibit I.C30.EGDI.APPrO.10c)
57 Exhibit I.C30.EGDI.APPrO.10 c iii and iv, page 3
58 TCU3.19 Table 1, column 2 minus column 1 for 2014

($7.37 - $9.96)[59] would still be minor on other customer classes relative to their allocated revenue requirement.

60. Enbridge has indicated that if the Board were to approve the changes requested by APPrO that the Site Restoration Cost (SRC) refund would also have to be reduced.[60] APPrO agrees with Enbridge.

61. Mr. Stevens, in his cross examination of Mr. Todd, suggested that if only certain larger XHP pipe sizes are going to be allocated to Rate 125, then the respective Delivery Demand Factors should also be adjusted to reflect only the flows going through those larger XHP pipes.[61]

62. Mr. Todd rejected this logic:

> *"MR. TODD: No. You are not doing anything with demands. What we are modifying is the way costs are bundled, what the cost allocation factors get applied to.*
>
> *So you have the same allocation factors. The point is that that factor, identified there as delivery demand TP, with a factor defined by class demands, would be applied to -- you would use that only for costs that are caused by all of the customers that have non-zero numbers. i.e., that allocation factor would only be applied to the larger-volume TP pipe.*
>
> *And the simplest implementation of our recommendation would be to then define a new allocation factor, which would be exactly the same as delivery demand TP, except that the Rate 125 would be zero, because they have no demand that causes those low-volume, small-pipe costs, and that new factor would be applied to that second bundle of costs."*[62]

63. Mr. Roger made a similar observation and testified that:

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59 TCU3.19 Table 1, column 4 minus column 1 for 2014
60 TCU3.19 page 2
61 Transcript Volume 11 page 102-109
62 Transcript Volume 11 page 108

> *"Something similar that we are suggesting here for the XHP, that there are pipes there that Rate 125 customers do not use. Theoretically they could, but they do not. So that is the reason that we think it is a functionalize -- sub-functionalization that we are trying to do. Instead of having one function called XHP, we have two categories. One could be 12 inches and above and the other one below. The allocators are not changing. It's just the dollar we are apportioning, that we are changing, but we are -- still cost causality is very important."*[63]

64. APPrO expects that Mr. Stevens simply misunderstands the design practices and operation of Enbridge's XHP system. The maps provided in response to IR APPrO.6[64] illustrate that gas normally flows from large diameter XHP pipes to small diameter XHP pipe.

65. Enbridge further defines XHP pipe as:[65]

> *TP Capacity refers to pipeline capacity costs of the XHP system used to move gas from upstream transportation pipelines to the rest of the distribution grid. Pipes of any size which operate at a pressure greater than 1207 kPa (175 psi) are included in the XHP system.*

66. Looking at the maps in APPrO.6 it becomes obvious that the interconnections with TransCanada and Union in most if not all cases are 12" and above. (Enbridge does not show the location of the upstream transmission systems feeding its XHP system on APPrO.6; therefore it is helpful to also refer to review IRs SEC.2[66] and CCC.33[67] to see how these XHP systems are fed from these upstream pipelines.)

67. A good example can be readily seen on page 5 of APPrO.6. In the lower right hand corner of the map, a 12" line runs northerly (from an interconnection with TransCanada). Some distance to the north, the load splits 3 ways, an easterly, westerly and a northerly flow. The east and west branches are 8" which in turn reduce to 4" and on a sub branch further reduces to 2". The northerly segment is not labeled, so presumably it continues as

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63 Transcript volume 11, page 130, lines 9 to 18
64 Exhibit I.C30.EGDI.APPrO.6
65 Exhibit I.C30.EGDI.APPrO.7a)
66 Exhibit I.A1.EGDI.SEC.2
67 Exhibit I.E45.EGDI.CCC.33

a 12”, but it too subsequently reduces to a 6” pipe. This can also be seen on the same map in the extreme lower left side of the map, where 16” pipe feeds a 4” and then a 2” pipe. In fact looking at all the maps of the XHP system this telescoping effect from large diameter to small is clearly evident.

68. Natural gas generally flows through the large diameter XHP system first and then to the smaller diameter XHP system and the lower pressure systems, so that when Elenchus proposes to split the XHP system between “category one” (12 inches and above) and “category two” (below 12 inches), it does not mean that there are now different customers using the category one XHP. It is still the same customers (all of them) with the same cost responsibility as determined by the peak day allocator. The allocator is still valid, based on cost causality, to allocate category one XHP, since the allocator reflects how the XHP category one is used. If not all customers use XHP category one, then the allocator would have to be different, but that clearly is not the case.

69. It is worth noting that Enbridge at no time raised in the evidence, or in responses to Interrogatories[68] and Undertakings,[69] any concerns about the allocators. The only evidence about allocators is Mr. Todd’s response to the questions raised by Mr. Stevens. That evidence is clear. If Enbridge had a factual concern about the allocators, it was for them to raise it in evidence when their panel was sworn. Enbridge chose not to, because there is no legitimate concern. Rather, Enbridge’s counsel is attempting (again) to confuse the issues. It is not now open for Enbridge to produce new evidence in argument which cannot be tested by the parties.

70. The rate impact of over allocating XHP assets to Rate 125 is material to this customer class and should be modified at this time. The 2014 revenue requirement for Rate 125 both ‘as proposed’ and ‘excluding 8” and smaller’[70] XHP pipe from Rate 125 is $9.96

[68] Exhibit I.C30.EGDI.APPrO.10c) - Enbridge provided the impact of not allocating mains of 4 inches and less to Rate 125 customers and did not identify the issue of having to develop new allocators under this scenario.

[69] TCU3.19 - Enbridge provided the impact of not allocating mains of 4 inches and less, 6 inches and less, and 8 inches and less to Rate 125 customers and did not identify the issue of having to develop new allocators under this scenario.

[70] Since Enbridge does not use 10” XHP pipe 8” and smaller is the same as smaller than 12”

million and $7.37 million respectively. The difference between these amounts is $2.59 million. Therefore the as proposed revenue requirement allocated to Rate 125, is ($2.59 million/$7.37 million) 35% higher than it should be if these smaller XHP pipe sizes were not allocated to the rate class. Since Enbridge recovers the entire revenue requirement associated with Rate 125 customers in fixed costs, therefore the percentage rate impact to any customer is the same as the percentage revenue requirement impact.

71. The proposed rate increases also materially and abruptly changes *the deal* between Enbridge and its Rate 125 customers. As Mr. Todd points out,[71] Rate 125 was a rate developed for large volume customers to discourage bypass of the utility and the changes now being proposed by Enbridge will have precisely the opposite effect. Future large volume customers in the Province may be more likely to pursue bypass given Enbridge's disposition to allocate costs to Rate 125 customers which are not caused by them.

G. APPrO Proposal 2 - Double Counting of Capacity

72. Elenchus identified in its report that there is double counting of the cost of excess XHP pipe capacity for Rate 125 customers.[72]

73. Elenchus' provided evidence that when a new Rate 125 customer comes on line, Enbridge designs and builds new XHP pipe capacity equal to the full new peak day load regardless of the excess capacity that exists in the system at the time.[73] This was confirmed by Enbridge in a prior proceeding and referenced by Elenchus in its report.[74] Enbridge did not refute this point at any time in this proceeding. The full cost of providing all of this new capacity to meet its full peak day load is included in the economic feasibility test for the Rate 125 customer.

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71 Transcript Volume 11 page 93
72 Exhibit L-2 Section 4.2
73 Exhibit L-2 page 14-15
74 Exhibit L-2 page 15 footnote 24

74. From time to time, Enbridge adds new XHP capacity to meet the long term[75] (up to 20 years) needs of its general service customers. Enbridge has stated that it does not take into account any growth for any contract customer[76] in this planning process.

75. In this Application, Enbridge is seeking approval for recovery of the costs in its Customized IR plan associated with several XHP reinforcement projects including, its GTA Reinforcement Project ($571.6 million),[77] its Ottawa reinforcement ($51.1 million),[78] and various other smaller XHP reinforcement projects ($54.6 million).[79] These projects add capacity to the XHP system that is intended to serve up to the 20 year growth needs of the general service customers.

76. Enbridge currently allocates the cost of this excess capacity in the same manner as all other XHP capacity and recovers it from all customers based on the current approved cost allocators. The effect is that until such time as the load growth occurs in the general service rate classes, all customers, including all contract customers, pay for this excess capacity that was constructed for the general service rate customers.

77. Elenchus points out in its evidence that charging Rate 125 customers both the cost of excess capacity in the XHP system as well as the cost of incremental capacity to serve its full peak day load without allowing such customers access to the existing excess capacity in the XHP system is double counting.

78. Elenchus recommended that Enbridge should be directed to either amend its economic feasibility test as it applies to Rate 125 or modify its cost allocation methodology so that Rate 125 customers are not required to pay for excess capacity in the system in two ways.[80]

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75 Transcript Volume 6 page 34
76 Transcript Volume 6, page 35
77 Exhibit B2-3-2 Table 1
78 Exhibit B2-3-2 Table 1.
79 Exhibit B2-3-1 page 5 years 2014-2016 plus 2017 and 2018 assumed at the same capital forecast level as 2016
80 Exhibit L-2 page 16

79. Mr. Todd explored Elenchus' recommendation on this issue in his cross examination by Enbridge and he noted that to change the economic feasibility test would be meaningless as it was his understanding that there were no more Rate 125 customers expected to come on the system.[81] Therefore existing Rate 125 customers, in addition to paying for all the capacity required to accommodate their full load, will also continue to pay for future excess capacity.

80. APPrO agrees with Elenchus that Enbridge's practice of both including the cost of all the capacity required to meet their full load, in their feasibility test, independent of existing excess capacity in the XHP system, as well as also charging for the ongoing excess capacity in the XHP system represents double counting. APPrO has termed this the Double Counting Issue. Double charging is not consistent with cost causality principles.

81. In the interrogatory process, APPrO had requested a working copy of the cost allocation model, but Enbridge declined to provide it.[82] As a result, Elenchus was unable to further study this issue in detail to develop an equitable solution for all parties. Moreover this issue does not just affect Rate 125 customers. Since Enbridge only builds excess capacity for the long term needs of its general service rate customers, all contract customers, including but not limited to Rate 125 customers have to pay for this excess capacity until such time as the excess capacity is utilized. Even when the existing excess capacity is fully utilized, it does not permanently resolve the issue of who should pay for this capacity. As demonstrated in this Application, Enbridge evaluates the remaining capacity in its distribution system on an ongoing basis and regularly develops additional XHP capacity to meet the long term needs of its general service market. So, as long as the peak day needs of its general service customers continues to grow, Enbridge will continue to add XHP capacity that will be in excess to its immediate needs. This will be an ongoing issue that should be addressed.

[81] Transcript Volume 11 page 112
[82] Exhibit I.C30.EGDI.APPrO.10d)

82. Enbridge has, in its evidence-in-chief, summarized Enbridge's initial attempt to interpret and implement the Elenchus recommendation in respect of the Double Counting Issue. Enbridge found that "the impact on Rate 125 customers would be approx. $0.5M in 2016 (of less costs being allocated to Rate 125). The $0.5M would then be allocated to and recovered from Enbridge's other customers."[83]

83. APPrO rejects Enbridge's evidence in this regard. Enbridge has obviously made a number of assumptions in trying to interpret and implement the Elenchus recommendation to estimate these impacts. However, Enbridge chose not to put any of its analysis on the record in this proceeding for the benefit of the Board or the scrutiny of the parties or their experts. What we know is that Enbridge concludes that its own interpretation and implementation of the Elenchus recommendation requires Enbridge to deviate from its standard approach to postage-stamp ratemaking.[84]

84. Elenchus had several options in mind when they made their recommendation. APPrO believes that any solution should be equitable to all rate classes. Elenchus was not able to explore potential solutions without a working copy of the Enbridge cost allocation model. Consequently, APPrO recommends that the Board direct Enbridge to study this Double Counting Issue in more detail. APPrO further recommends that Enbridge should be obligated to work with an Enbridge-funded stakeholder working group to discuss the issue and seek input and consensus on recommended solutions. It is proposed that Enbridge complete this in 2015, ideally in time for its 2016 rate filing.

H. The Question of Timing

85. In Exhibit K11.1 Enbridge suggests that "[i]f changes were to be made to Enbridge's Board-approved cost allocation methodology, then the Company's view is that the proposed changes would need to be evaluated on a comprehensive basis rather than only on the basis of treatment of specific investments."

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[83] Exhibit K11.1 at pg. 3.
[84] Ibid. at pg. 4.

86. Mr. Todd, an experienced independent expert, opined directly on this issue in response to a question from Enbridge's counsel:

> *MR. STEVENS: And do you agree with the statement Mr. Kacicnik made this morning that if Enbridge is to consider changes to Rate 125 it is appropriate to look at the broad range of options available?*
>
> *MR. TODD: No, I don't agree with that. In my history of dealing with cost allocation with Enbridge, which goes back almost 25 years, I have been in many Enbridge proceedings, I think at times Consumer Gas proceedings, where modifications to the cost allocation methodology were proposed. I can remember hearings where there were half a dozen tweaks being proposed. It was not part of a complete review and overhaul.*
>
> *All parties had an opportunity -- usually it was Enbridge who took the lead -- to identify specific areas where they felt that a change would be consistent with improving the allocation in accordance with cost causality principles, and probably in 90 percent of those cases the Board was persuaded that the tweak would be an improvement, and they had accepted it without a complete review of the entire cost allocation model, but rather making small and incremental improvements to the model.*[85]

87. The APPrO recommendations should not be refused simply because they were not discovered as part of a comprehensive review of Enbridge's cost allocation methodology. Enbridge did not undertake a comprehensive review of its cost allocation methodology in its Application, and presumably any such review would not occur until the end of the current 5-year term of its Application.

88. In the interim, Enbridge is proposing a cost allocation method that is known to be flawed in that it fails to address the Over-Allocation Issue to the detriment of all existing Rate 125 customers. There are very real, and unfair, financial consequences to Rate 125 customers of not addressing the Over-Allocation Issue now, which are set out in Enbridge's response to TCU3.19.

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[85] Transcript Volume II, Page 98

89. In this context, Elenchus' comments ring true that "subject to issues of availability of data and practicality, there is a predisposition to adopt refinements that result in an allocation that better reflects cost causality."[86]

90. In this case, the data is readily available to immediately adopt the practical refinement to Enbridge's cost allocation methodology proposed by APPrO to address the Over-Allocation Issue. This refinement will ensure that Enbridge's cost allocation methodology better reflects cost causality for Rate 125 customers. There is simply no good reason to delay this change. Such a delay would mean that Rate 125 customers as a class would continue to be over-charged 35% for assets that Enbridge readily admits are neither caused by nor being used to service any customers in the Rate 125 customer class.

91. APPrO has made a suggestion to improve the Enbridge model on an incremental basis. If there are more improvements, those can be brought forward on an incremental basis at some future date. APPrO's second recommendation proposes to do exactly that.

III. APPRO'S SUBMISSIONS ON THE REST OF THE APPLICATION

Summary Position

92. APPrO takes no position on the appropriateness of the Customized IR plan as a whole for the period 2014-2018. APPrO does however have several concerns with specific elements of the plan and these concerns will be discussed under the individual issues from the Issues List. APPrO has not commented on all issues on the issues list, only those where it takes an active position.

93. While APPrO takes no position on the form of the Customized IR plan, it does note that Union Gas has agreed to, and the Board has approved, an (I-X) IRM for the next 5 years.[87] Union operates in the same environment from a safety and technical standards perspective and also has unprecedented levels of growth in capital spending over the next several years. APPrO does acknowledge that a utility may have capital requirements that

[86] Exhibit L, Tab 2, Schedule 1, Page 18 of the Exhibit (page 11 of the report). Lines 9-11.
[87] EB-2013-0202 Decision

periodically are at levels that are not consistent with historical levels. The Union IRM Settlement Agreement demonstrates that an agreement with a capital module that presumably meets the needs of the utility within the context of an (I-X) incentive rate plan is possible.

94. APPrO further notes that in 2013 Enbridge over earned by $31.2 million.[88] This elevated earning level implies that the 2013 Board approved revenues and cost projections for 2013 were conservative in Enbridge's favour. This also suggests that the (I-X) model has worked for Enbridge in spite of higher than forecast capital spending.[89]

A. Enbridge's Customized IR Plan

<u>Issue A1</u> Is Enbridge's proposal for a Customized IR plan for a 5 year term covering its 2014 through 2018 fiscal years appropriate?

95. Enbridge has filed a Customized Incentive Rate (Customized IR) plan as the basis to set rates commencing January 1, 2014 through to and including December 31, 2018. The Customized IR plan includes: [90]

(a) An Allowed Revenue for each year,

(b) An annual adjustment process to change rates based on the Allowed Revenue, updated forecast of customer volumes, and certain flow through Y factors, such as gas costs, pension amounts, Demand Side Management (DSM) costs and customer care costs.

(c) A process to adjust 2017 and 2018 Allowed Revenues based on updated forecasts of capital spending. Subsequently to the original filing and the finalization of the issues list, Enbridge updated its filing and has set capital budgets for 2017 and

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88 *Ibid*. line 28
89 Exhibit J1.2 page 3 line 1
90 Exhibit A1 Tab 2 Schedule 1 paragraph 3

2018 and APPrO understands that this adjustment process is therefore no longer necessary.

(d) Certain deferral and variance accounts,

(e) A request for ‘Z factors’ to cover certain unexpected costs

(f) An Earnings Sharing Mechanism

(g) An Off Ramp that could be triggered during the Customized IR period

(h) A Sustainable Efficiency Incentive Mechanism (SEIM)

96. APPrO’s concerns with specific elements of Customized IR plan are expressed under the discussion of the individual issues below.

97. Enbridge has stated that the rationale to move away from a more traditional (I-X) IRM is due to the increased requirements for capital spending related to safety and integrity issues, system reinforcement capital, work asset management and growing depreciation.[91] Enbridge has stated that it cannot continue with a similar (I-X) model as it had before.[92]

98. Moving to a Customized IR plan is a significant departure in many respects from the prior (I-X) model used by gas and most electric LDCs and which continues to be used by Union. While Enbridge’s proposed Customized IR plan appears to be modeled on the RRFE model allowed for electric LDCs, it is not simply an application of that RRFE custom IR model. Rather Enbridge rejects various limitations which are built into the RRFE model which all electric LDCs must live with.

99. The Customized IR plan forecasts capital costs through the five year period. APPrO is concerned that there has been no third party verification of either the need for some of

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[91] Exhibit A2 Tab 1 Schedule 1 paragraph 10
[92] *Ibid*.

this capital or any verification of the capital cost estimates. Dr. Kaufman in his evidence also raised concerns about the reasonableness of Enbridge's cost forecasts.[93] Furthermore Mr. Sanders acknowledges that they did not materially use any external resources to confirm their budget estimates other than using Aird & Berlis and Mr. Betts.[94] It is not clear what expertise these parties may have to verify utility capital or operating cost estimates. APPrO does note that Enbridge did seek third party verification for its WAMS project. This project has been forecasted at $67.7 million.[95] Sync Energy provided a range of $50-75 million.[96] Sync's upper estimate of the range is 50% more than their lower estimate and Enbridge's estimate is in the upper third point within this range. It is questionable if this broad estimate range is helpful to verify the Company's estimate.

100. APPrO acknowledges that capital spending is expected to be higher in the next several years. One of the sources of increased spending is new reinforcement projects. Enbridge has received approval for the GTA and Ottawa reinforcement projects. APPrO understands that the Ottawa project has been constructed and is in service. Enbridge has requested a deferral and variance account for the GTA project to capture differences from estimated costs. Subject to issues of spending prudence, this should eliminate the capital cost risk to Enbridge for the GTA project, which APPrO understands is Enbridge's largest capital project.

101. There has also been a substantial increase in Enbridge's core[97] capital budget during the Customized IR plan compared to the 2013 budget.[98] This change, for the most part, is being driven by system improvements and upgrades; often due to age and condition of the existing assets. Replacing assets due to age and condition has, by its very nature, some level of subjectivity in deciding the appropriate time to upgrade or replace an asset. APPrO acknowledges that legislative changes related to integrity management, may be

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93 Exhibit L Tab 1 Schedule 2 page 6
94 Transcript Volume 5 pages 91-93
95 Exhibit B2 Tab 8 Schedule 2 Table 1
96 Exhibit B2 Tab 8 Schedule 1 Attachment Section 3
97 Excludes GTA, Ottawa and WAMS
98 Exhibit B2-1-1 page 3

driving the need for some of the proposed changes. APPrO supports the need for the utility to operate in a safe and reliable manner. APPrO however, shares the concern expressed by Dr. Kaufmann that without some form of benchmarking or third party review there is a potential for the capital budgets to use conservative assumptions to derive the estimates. In order to subsequently assess if such budgets are reasonable, the Board should require Enbridge to include an annual review of its capital spending comparing its budget to its actual expenditures and providing variance explanations of significant differences.

102. APPrO notes that the Union IRM Settlement Agreement[99] includes cost recovery for large capital projects that, subject to the project meeting certain minimal capital and annual owning and operating cost thresholds, allows new capital projects to be included in rate base. This type of methodology both protects the utility in the event of the need to construct a major capital project, and since smaller capital projects have no individual cost recovery mechanism (but are covered by the (I-X) mechanism), it incents the utility to act more efficiently in managing this spending, significantly more so than under the Customized IR plan.

Issue A2 ***Does Enbridge's Customized IR Plan include appropriate incentives for sustainable efficiency improvements?***

103. The primary mechanism that Enbridge advances to create sustainable efficiency improvements is their SEIM proposal. This is dealt with in more detail under Issue 10 f).

104. Enbridge is also introducing several new systems and technologies (WAMS,[100] bar coding and GPS[101]) that may have the potential to create long term efficiencies, but Enbridge has not provided any quantifiable details about how these tools will be used to improve productivity.

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99 EB-2013-0202
100 Exhibit B2-8-2
101 Exhibit B2-5-5 page 2

105. Enbridge indicates that improved productivity is implied because they are keeping FTE's constant.[102] In fact FTE levels have increased substantially since 2011, by about 15%. The FTE levels over the last several years include:

(a) 2011 2,070 actual[103]

(b) 2012 2,231 estimate[104]

(c) 2013 2,388 Board approved[105]

(d) 2014 2,377 budget[106]

106. APPrO submits that the recent significant increase in FTEs and the ongoing level of vacancies in the organization do not imply the improved productivity during the term of the Customized IR plan that is being asserted by Enbridge.

***<u>Issue A9</u>* Are the cost of capital parameters for 2014 to 2018 (ROE, debt rates) within Enbridge's Customized IR plan appropriate?**

107. During the term of the IRM Enbridge proposes to fix its capital structure ratios. This includes a constant equity ratio of 36%.[107] Enbridge is also proposing set the ROE for each year of the Customized IR plan based on the Board's ROE formula using Enbridge's estimates for Long Canada Bond Yield and the Utility Yield Spread between the Canada 30 year Utility Bond Index and the 30 year Government of Canada Bond Spread.[108]

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102 Exhibit A2 Tab 1 Schedule 2 page 6
103 Exhibit K5.7 Tab 11 (page 23 of 25) Column b, line 36
104 *Ibid*. column a, line 36
105 Exhibit D3 Tab 2 Schedule 3 Column b, line 35
106 *Ibid*. column a, line 35
107 Exhibit A2-5-1
108 Exhibit E2-1-2 Page 2

108. The Board has previously determined that it must use informed judgment in and apply its discretion in setting the utility's cost of capital:[109]

> *…the Board notes that the Fair Return Standard is sufficiently broad that the regulator that applies it must still use informed judgment and apply its discretion in the determination of a rate regulated entity's cost of capital.*

109. The Board also stated:[110]

> *The Board is of the view that each time a formulaic approach is used to calculate an allowed ROE it must generate a result that meets the FRS, as determined by the Board using its experience and informed judgment.*

110. In determining the appropriate ROE for each year of the Customized IR plan, the Board should take the following additional factors into account:

   (i) The 2014-2018 input parameter forecasts used in the calculation to determine the ROE were prepared by Enbridge in the first quarter 2013,[111] and by their very nature these long term estimates will have some level of inaccuracies. The Board should take into account the potential for error in these estimates provided.

   (ii) APPrO notes that Enbridge continues to increase the number of deferral and variance accounts. These deferral and variance accounts will reduce the risk exposure for Enbridge. During the term of the Customized IR plan, Enbridge will have between 23-25 deferral accounts.[112] This reduced risk should be reflected in the final ROE approved by the Board.

111. The best metric available to the Board for ROE during the term of the Customized IR plan is the return agreed to between Union and its stakeholders for the same period[113] of 8.93%. APPrO believes that the ROE should be fixed at 8.93% during the full term of the Customized IR plan.

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[109] EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities page i
[110] *Ibid*. page 29
[111] Exhibit E2-1-2 page 2
[112] Exhibit J2.1
[113] EB-2013-0202 Settlement Agreement

112. An 8.93% ROE will reduce the revenue requirement over the 5 years by an estimated $130 million.[114]

Issue A10 ***Are the following components within Enbridge's Customized IR plan appropriate?***

Issue A10a) ***Z-Factor mechanism***

113. Enbridge proposes to include a Z-factor mechanism in its Customized IR plan to:[115]

> *… protect the Company and ratepayers from unexpected costs that are outside management's control*

114. Enbridge also proposed alternative language than what has been previously agreed to in Enbridge's prior Incentive Rate Mechanism (IRM). Enbridge also proposes an eligibility threshold of $1.5 million for a Z-factor to apply. More specifically:[116]

> A cost increase or decreases will be treated as a Z-factor if it meets all four of the following criteria:
>
> - *Causation: The cost increase or decrease, or a significant portion of it, must be demonstrably linked to an unexpected, non-routine cause.*
>
> - *Materiality: The cost at issue must be an increase or decrease from amounts included within the Allowed Revenue amounts upon which rates were derived. The cost increase or decrease must meet a materiality threshold, in that its effect on the gas utility's revenue requirement in a fiscal year must be equal to or greater than $1.5 million.*
>
> - *Management Control: The cause of the cost increase or decrease must be: (a) not reasonably within the control of utility management; and (b) a cause that utility management is unable to prevent by the exercise of due diligence*

114 Transcript Volume 10 page 4
115 Exhibit A2-4-1 page 1
116 Exhibit A2-1-1 page 1-2

- *<u>Prudence</u>: The cost subject to an increase or decrease must have been prudently incurred.*

115. The prior Z-factor language agreed to between stakeholders and Enbridge included:[117]

- *the event must be causally related to an increase/decrease in cost;*
- *the cost must be beyond the control of the Company's management and is not a risk in respect of which a prudent utility would take risk mitigation steps;*
- *the cost increase/decrease must not otherwise reflected in the per customer revenue cap;*
- *any cost increase must be prudently incurred; and the cost increase/decrease must meet the materiality threshold of $1.5 million annually per Z factor event (i.e., the sum of all individual items underlying the Z factor event).*

116. APPrO is opposed to the new language and proposes that the language in the Customized IR plan remain the same as it was in the IRM to determine the eligibility of an event to qualify as a Z-factor.

117. APPrO is of this view because the Enbridge proposal fundamentally expands the traditional Z-factor by (i) lowering the threshold for all costs to be causally related to the Z-factor event ("or a significant portion of it"), (ii) increasing the scope of possible Z-factor events ("an unexpected, non-routine cause"), and (iii) lowering the requirement that the costs incurred must beyond management's control ("a cause utility management is unable to prevent by exercise of due diligence").

118. In the alternative, should the Board accept Enbridge's proposal to greatly expand the circumstances where Z-factor relief may be available – APPrO is of the view that this reduction in utility risk should be accompanied by an equivalent reduction in the allowed ROE.

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[117] Exhibit A2-4-1 page 4

119. APPrO notes that in this Customized IR plan, Enbridge has developed its expected forecasted costs for the next 5 years. These forecasted costs have, for example, already taken into account recent legislative changes affecting natural gas utilities. This is in contrast to the (I-X) type IRM where future costs are set by an inflation factor where budgets are unable to take into account expected upcoming changes. In addition, Enbridge has significant capital and operating budgets, which provides them the ability to reprioritize projects within the term of the Customized IR plan to ensure that the most important work will be completed first.

120. As a result of these differences between the IRM and the Customized IR plan, and the ability to reprioritize expenditures within the 5 year plan, APPrO further proposes that the materiality threshold for Z-Factor relief be increased to $4 million.

<u>Issue A10 c)</u>* *Earnings Sharing Mechanism (proposed at a 100 bp deadband and 50/50 thereafter)

121. Enbridge is proposing to change the current earnings sharing mechanism (ESM) in favour of a 100 bp deadband and a 50/50 sharing thereafter. Enbridge has indicated that:[118]

> *…the main purpose of proposing an ESM is to give greater credibility to Enbridge's cost forecasts to the OEB and stakeholders*

122. APPrO is concerned that as currently proposed, the ESM has the effect of increasing Enbridge's allowed ROE by a further 100 basis points before Enbridge is required to share any earnings with ratepayers. If the additional 100 basis point is required to better reflect Enbridge's risk profile, then that argument should be addressed as part of establishing the allowed ROE.

123. APPrO understands that an ESM may result in a return of a portion of costs to ratepayers that result from over forecasting. This earnings sharing mechanism though, still results in the majority of the savings remaining with Enbridge. APPrO believes that cost forecasts

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[118] Exhibit A2-7-1 page 1

in a five year Customized IR plan should first be validated through objective, external evidence as described by Dr. Kaufmann.[119] Not to do so may in fact create a bias to over forecast its costs as a means to enhance earnings.

124. Ideally all of the cost savings generated would accrue to the ratepayer, however this would take all the incentive away from the utility to seek out such savings and discourage the desired outcome.

125. APPrO is proposing a more balanced earnings sharing mechanism for this Customized IR plan for the Company and the ratepayer to both benefit from all savings achieved on a 50/50 sharing for the first 100 bp to create a reasonable incentive for the Company to continue to seek out cost reductions and increase earnings. After 100 bp, the benefits should then be shared 90/10 in favour of the ratepayer. Such an approach ensures that Enbridge continues to be incented to achieve cost savings to facilitate over-earning, while protecting ratepayers by ensuring that 50%, and after the 100 bp threshold is reached 90%, of the benefit of such over earnings go directly to the benefit of ratepayers. This is particularly important given Enbridge's history of over-earning, which is likely a result of overly conservative forecasts during prior rate cases.

<u>Issue A10 f)</u> Sustainable Efficiency Incentive Mechanism (SEIM)

126. Enbridge is proposing to establish the SEIM to create a reward for Company to introduce long term sustainable productivity gains to benefit the customer. Enbridge is proposing a three step process to determine the Company's share of the reward:[120]

(i) <u>Step 1</u>: Determine the reward potential, by comparing the average actual ROE for each year of the IR term to the Board-Allowed ROE for each year. The SEIM reward will then be one-half the difference between the average ROE achieved (after earnings sharing)[121] and the Allowed ROE. This result, if positive, would then be reduced by 50%. The SEIM reward

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[119] Exhibit L-1 page 23
[120] Exhibit A2-11-3 pages 8-12
[121] TCU1.14 updated

for each of the two years would then also be capped at 50 bp above the allowed ROE (the ROE Premium).

(ii) Step 2: To qualify for the SEIM reward, the NPV of the productivity initiatives must be greater than the reward, and the Company's service and performance levels must be maintained.

(iii) Step 3: The SEIM reward payout would occur in each of 2019 and 2020. The Reward for each of 2019 and 2020 would then be calculated as:

- ROE Premium X 2019 Rate Base X 2019 Equity Ratio

127. While the concept of a reducing the long term costs to customers has merit, the proposal to incrementally compensate the Company for doing what they should be expected to do under any circumstances raises a number of issues that the Board should take into account.

128. Long term savings often result from the introduction of technical advances developed in the economy at large or at an industry level. Productivity improvements have been made by the Company in the past in adopting these advances. A good example is the use of computer technologies not only as an office tool but also as a job-site tool. Advances in telecommunication no doubt have also improved access to information thus improving productivity. Similarly, the use of plastic pipe has reduced material and installation costs of new mains and services.

129. Enbridge has already proposed the use of Bar Coding and GPS as tools to assist its record management program.[122] These tools, like many that have come before them, should improve productivity and reduce costs. It appears though that Enbridge has not invented these technologies but is applying them to their business. The question is to what extent should Enbridge be awarded for adopting technologies developed by others?

130. Put another way, should the expectation of continuous improvement be embedded in the Fair Return Standard? APPrO believes that it should. Non-regulated, competitive

[122] Exhibit B2-5-5 Attachment 2 page 2

companies are naturally incented to adopt reasonable productivity measures on a continuous basis; not to do so would put them at risk of becoming obsolete and would risk their asset base.

131. In this context, APPrO has several concerns with the SEIM as currently configured.

(i) The SEIM payout is based on the level of average ROE achieved over the Allowed ROE during the term of the Customized IR plan. Since no SEIM projects have been identified, it is likely that these SEIM related projects will take place later in the term and therefore it is more likely that the majority of ratepayer benefits will occur after the term of the Customized IR plan and after the SEIM payout has been determined. The value of these ratepayer benefits by its nature will therefore be speculative.

(ii) To the extent that Enbridge has incorporated conservative budget assumptions that subsequently results in over earnings, these assumptions could lead to greater SEIM rewards for Enbridge. These greater rewards would have no connection to the actual long term benefits that the ratepayer benefits.

(iii) Enbridge has indicated that they do not have any SEIM projects included in the application and SEIM benefits would be incremental to the current budgets.[123] However, the Company was unable to identify any SEIM initiatives that it was contemplating. This will make challenging for ratepayers to verify if the savings for future projects are already embedded in, or are in-fact incremental to, current forecasts.

(iv) Enbridge has also proposed that the reward that it receives is to be grossed up for taxes.[124] This will create the effect of the benefit to ratepayers being determined based on rate savings and the reward to the Company would then be grossed up for taxes. APPrO disagrees.

132. For the foregoing reasons, APPrO submits that the Board should reject the SEIM as proposed. However, in the event that the Board approves a SEIM mechanism for Enbridge, the Board should give consideration to several modifications both now and at the time that the SEIM calculations are completed for 2019:

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[123] Transcript Volume 2 page 136
[124] Transcript Volume 1 page 44

(i) Actual ROE calculations should be further adjusted to remove the impact of O&M budgets or capital amounts that have been found to be overly conservative, or if it is found that projects or costs have been deferred into the future.

(ii) APPrO believes that there should be a greater degree of comfort that ratepayers are truly benefiting from such initiatives. Therefore in order to encourage Enbridge to prioritize resources on those projects that have the most ratepayer benefit, APPrO recommends that the ratepayer benefit must be at least twice the potential payout to Enbridge.

(iii) Competitive companies must implement productivity improvements on a continuous basis to stay in business. In setting the ROE pursuant to the Fair Return Standard, the Board should also recognize the potential future rewards that Enbridge may collect from implementing productivity improvements under the SEIM.

(iv) Any future SEIM savings ought to have some level of independent assessment to verify the forecasted savings.

(v) Any SEIM payouts should not be grossed up for taxes.

B. Allowed Revenue and Rate Base

Issue B17 ***Is the Allowed Revenue amount for each of 2014, 2015, and 2016 appropriate, including:***

Issue B17b) ***Is the operating costs amount appropriate?***

133. Enbridge acknowledges that typically there are about 100 FTEs vacant at any time and in fact are currently holding 120 vacancies,[125] the current net FTEs are approximately 2,257 (2,377-120). Staff turnover in any organization naturally results in temporary vacancies while the role is filled. The O&M budgets however do not reflect the cost savings associated with these ongoing vacancies.

134. APPrO recommends that O&M budgets (salaries and wages, benefits and short term incentives) be adjusted to reflect the fact that more than 100 FTE positions are currently,

[125] Transcript Volume 7 page 182

and are likely to remain, vacant. For the years 2014-2018 the proposed adjustments are $9.1 million, $9.4 million, $9.7 million, $9.9 million and $10.2 million respectively. The table below shows the derivation of these amounts (assuming a continuation of the historic average vacancy level of 100).

Enbridge O&M Budget Impact of Reducing 100 FTEs

($000)	2014	2015	2016	2017	2018
Salaries and Wages	$ 170,572	$ 174,609	$ 178,977	$ 183,113	$ 188,826
Benefits	$ 25,756	$ 26,350	$ 26,925	$ 27,765	$ 28,632
Short Term Incentive Program	$ 21,156	$ 21,628	$ 22,116	$ 22,806	$ 23,518
Total	$ 217,484	$ 222,587	$ 228,018	$ 233,684	$ 240,976
FTEs	$ 2,377	$ 2,365	$ 2,361	$ 2,361	$ 2,361
Unit Cost/FTE	$ 91.50	$ 94.16	$ 96.58	$ 98.98	$ 102.07
Reduction for 100 FTEs	**$ 9,150**	**$ 9,416**	**$ 9,658**	**$ 9,898**	**$ 10,207**
Source	D3-2-3 lines 1-3 & 35	D4-2-3 lines 1-3 & 35	D5-2-3 lines 1-3 & 35	D6-2-3 lines 1-3 & 35	D7-2-3 lines 1-3 & 35

C. 2014 Rates

Issue C21 ***Is the 2014 forecast of Customer Additions appropriate? And***

Issue C22 ***Is the 2014 revenue forecast appropriate?***

135. APPrO believes that the 2014 forecast of contract rate customer additions are overly conservative and should be increased. Through the five year term of the Customized IR plan, Enbridge is proposing to annually re-file a volume forecast and rates would be predicated on such volumes. Enbridge appears to be taking a very conservative approach to forecasting contract additions for the year in which rates are being established.

136. Subsequent to the period of financial crisis (between 2010 and 2012), Enbridge has under forecast contract volumes by an average 6.2%.[126] Also in 2013 the Board approved contract revenue was $83.7 million.[127] Enbridge exceed this forecast by $1.9 million[128]

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126 Exhibit C1-2-1 Appendix A Page 5 Table 4 (For the years 2010-2012 sum of column 4)
127 Exhibit C3-2-4 line 4 col 2
128 Exhibit J1.2 page 5 item a)

or 2.3% compared to Board approved revenue. This is a 4 year average under forecast of contract volumes by over 5%.

137. Enbridge acknowledged that the process to forecast contract volumes is completed in the first quarter of the test year [129] to be able to have sufficient time to input this information into the balance of the rate adjustment filing.

Negotiations with potential customers ending in contracts subsequent to this quarter will be missed until the year following the test year.

138. Enbridge provided a series of Key Economic Assumptions for Ontario[130] and acknowledged that these indicators were conducive to contract customer growth.[131]

> *MR. WOLNIK: So it seems to me that these are pretty good indicators of the economy as it relates to contract customers, and one would expect the opportunities for contract growth during this period to be fairly positive. Would you agree?*
>
> *MS. SUAREZ: Yes, I would agree.*

139. Despite these favourable conditions, Enbridge forecasts a decline of number of contract customers from 424 to 403[132] and a very marginal increase in customer volumes from 1945.5 10^6m^3 to 1966.0 10^6m^3.[133]

140. While this approach may have been understandable that during the financial crisis when economic conditions were not favourable to contract customer growth, current economic conditions now support a more positive outlook for growth.

141. APPrO recommends that Enbridge's revenue forecast for 2014 contract customers ($90.4 million)[134] be increased by the average amount that has been under forecast over

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129 Transcript Volume 7 page 13
130 Exhibit C2-1-1 page 1
131 Transcript Volume 7 page 4
132 Exhibit C3-2-2 line 4
133 Exhibit C3-2-3 line 4

the last 4 years. This is 5% or $4.5 million (5% X $90.4 million) and the 2014 contract customer revenue be revised to $94.9 million.

<u>Issue C30</u> Is Enbridge's utility Cost Allocation Study, including the methodologies and judgments used and the proposed application of that study with respect to 2014 Fiscal Year rates, appropriate?

Please see part II above.

<u>Issue C31</u> Are the rates proposed for implementation effective January 1, 2014 and appearing in Exhibit H, just and reasonable?

142. APPrO does not believe the rates as filed are just and reasonable and has recommended a series of adjustments to the rates throughout this argument.

<u>Issue C32</u> How should the Board implement the rates relevant to this proceeding if they cannot be implemented on or before January 1, 2014?

143. Enbridge has proposed Rider E that will credit ratepayers with the difference in revenue between interim and final 2014 rates for the period from January 1, 2014 to the dates that final rates are implemented.[135] APPrO understands that 2014 final rates are forecast to be lower than 2014 interim rates. APPrO agrees that these credits should be returned to customers by way of Rider E.

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[134] Exhibit C3-2-4 line 4
[135] Enbridge Argument in Chief dated March 31, 2014 page 78.

D. Alternative Proposals

E. Other

<u>Issue E35</u> What are the regulatory alternatives to the Board approving the Enbridge rate proposal? Are any alternatives to approving the rate proposal appropriate?

144. Board Staff has proposed that the Board adopt one of two modifications to Enbridge's proposed Customized IR plan. The first modification would be to retain the current rates as interim and require Enbridge to file additional evidence related to shortcomings in its Application regarding benchmarking of capital costs. The second option would be to impose a reduction in revenue requirement of $20 million per year to ensure that the appropriate amount of productivity is incorporated into the plan, and, as well, incorporate a stretch factor of 0.6% which would further reduce the revenue requirement by $6.3 - $7.8 m over the term.

145. APPrO has also expressed concerns throughout these submissions about the lack of benchmarking or other verification of capital costs in the Customized IR plan, as well as the need for Enbridge to implement productivity on a continuous basis.

146. While providing evidence on benchmarking may have merit in a future application, APPrO views that the time to demonstrate the appropriateness of Enbridge's budget has passed. This should have been part of the original Application. The Board should decide the Application on the basis of the evidence advanced by Enbridge to-date. APPrO does, however, see merit in staff's second proposal to reduce the overall revenue requirement by $20 million per year to reflect productivity improvements and to further provide for a stretch factor of 0.6% during the term of the Customer IR plan. These amounts would be in addition to, not in lieu of, APPrO's other recommendations.

<u>Issue E36</u> Is Enbridge's proposal for Transactional Services (TS), including the classification of transactions within TS and the treatment and sharing of TS revenues, appropriate?

147. Enbridge's current TS arrangements are to share TS net revenues 90/10 with ratepayers and continue the current $12 million embedded in the revenue requirement.[136] Enbridge also shares the variances from the $12 million net revenues, subject to a maximum debit of $4 million.[137] Enbridge proposes to eliminate the cap such that all variances would be shared without a cap.[138] Enbridge indicates that the rationale to change this sharing arrangement is based on TransCanada tariff amendments.

148. APPrO believes that while some TransCanada tariff amendments have occurred, there are other proposed changes resulting from the recent Settlement Agreement entered into between Enbridge (and other Eastern Canadian LDCs) and TransCanada that will allow for new revenue generating opportunities. These new potential opportunities are not reflected in the Enbridge rationale and therefore APPrO believes that no changes should be made at this time.

<u>Issue E43</u> Are the proposed changes to the Rate Handbook appropriate?

149. Enbridge is proposing a new section P to its Rate Handbook that provides for the following.[139]

> *All customers whose annual consumption exceeds 1,000,000 m3 are obligated to provide their expected annual consumption, peak demand, and emergency contact information to the Company annually.*

150. APPrO generally acknowledges that it is reasonable for the Company to have emergency contact information for large customers. It is also appropriate that the Company have

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136 Exhibit C1-3-2
137 *Ibid*.
138 *Ibid*.
139 Exhibit H2-6-1 Part III page 7 of 9

peak demand information to design its pipeline system. Annual consumption may also be important to Enbridge for those customers for which Enbridge procures the gas supply.

151. APPrO believes however that Section P should not apply to contract customers.

152. While it may not have been the intent of the Company, the clause appears to be worded to require the customer to initiate the information exchange without a request from the Company. If a customer fails to comply with this provision, the customer could be in default.

153. For contract customers, information of this nature should be agreed to between the parties and contained in the contract and therefore not be a general provision separate from the contract. Contracts specify the peak day demand and contact information for notices, and there should not be an additional onus on these customers to notify Enbridge of such information that is already contained in the contract.

154. New contracts with customers are initially entered for a long term, usually 20 years in the case of Rate 125 customers. Contracts that have come to the end of their primary term are usually renewed on year to year basis and, as part of the renewal process, the parties renegotiate peak day flows and other relevant contract parameters.

155. Section P is therefore redundant for contract customers.

156. It is APPrO's opinion that Enbridge did not provide a reasonable response to an interrogatory when asked how annual consumption was going to be used.[140] APPrO does not agree that Enbridge should be allowed to request this information unless it is purchasing gas on such customer's behalf. Some contract customers view this information to be commercially sensitive. As such they should not be required to provide this information unless there is a valid reason and further that there are sufficient assurances that such sensitive information will be appropriately safeguarded.

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[140] Exhibit I.43.EGDI.APPrO.6

157. In the event the Board does support the inclusion of Section P in the Enbridge Handbook, then APPrO recommends the following:

(i) That the provision only apply to non-contract customers;

(ii) That the information be provided upon a request from the company rather than the customer having to provide that information on its own initiative;

(iii) That Enbridge include a provision in the Handbook confirming that the Company will safeguard all customer specific confidential and sensitive information; and

(iv) That the requirement to provide annual consumption information be limited to those customers for which Enbridge procures gas supply.

***<u>Issue E44</u>* Is Enbridge's rate design for the proposed Rate 332 appropriate?**

158. Rate 332 is a proposed firm transmission service between Parkway and Albion (GTA Project Segment A). APPrO does not have comments on Rate 332 service. However, Enbridge is also reserving a portion of the capacity along this route for its own infranchise distribution requirements. APPrO understands that Enbridge's use of this route will primarily be used to meet its winter requirements. This route could have opportunities to generate Transactional Services (TS) revenue during off-peak periods using Enbridge's unused capacity. APPrO believes that Enbridge should also proactively develop a daily interruptible or similar service along the same route to utilize any unused capacity along this transportation path.

159. Mr. Denomy, on behalf of Enbridge indicated that Enbridge is considering such a service and would implement such a service if there was demand.[141] Opportunities to generate TS revenue can develop unexpectedly such as an outage of another pipeline. Further, since there is a lag between identifying the need, making an application for, and the ultimate approval of such a service; APPrO suggests that such a service be developed on

[141] Transcript Volume 8 page 52

a proactive basis and made available coincident with the timing of the GTA Reinforcement Project in-service date.

IV. CONCLUSIONS

160. APPrO requests that it be awarded 100% of its reasonably incurred costs. APPrO has raised various concerns with the Enbridge Application in its submissions. In doing so, APPrO worked with the other ratepayer groups throughout the application process so as to avoid duplication. Other parties have and will no doubt raise a variety of other concerns as well.

161. APPrO would like to conclude by focusing on the two key concerns APPrO and its experts have raised with the Enbridge cost allocation model: the Over-Allocation Issue and the Double Counting Issue. APPrO's concerns remain regardless of the form of incentive ratemaking used to establish rates for Enbridge.

162. There may be a temptation to not give sufficient attention to APPrO's cost allocation concerns in light of the various other issues in the Application. It appears that, without having the benefit of APPrO's written submissions, Board staff gave way to this temptation. For the Board to do the same would be a mistake. It would ignore the considerable effort that has gone into analyzing Enbridge's proposal by APPrO and its independent cost allocation experts. It would also ignore the clear evidence on the record that Enbridge's cost allocation proposal is fundamentally deficient – it allocates costs to the Rate 125 customer class that Enbridge admits are not caused by any customers in that class.

163. The Board should order Enbridge to immediately resolve the Over-Allocation Issue (as is more fully described in paragraph 18 above). This approach was recommended by APPrO's independent cost allocation experts. It is principles based and is entirely consistent with cost causality and postage-stamp ratemaking (as more fully described in paragraphs 24-41 above).

164. The Board should be wary of delay tactics. Such a delay would result in the continuation of Enbridge over-charging Rate 125 customers by 35% contrary to cost causality principles. And as was rightly noted by the OPA in a letter of comment - this, together with the other increases in this application, can in turn result in increases in underlying electricity rates.

165. There is simply no good reason to delay implementation of APPrO's recommendation. Enbridge already makes reference to the nominal pipe diameter of XHP assets in its cost allocation methodology when determining how much of the costs in its uniform system of accounts should be allocated to TP Capacity.[142] Given this practical reality, the use of nominal pipe diameter to further distinguish between high and low capacity XHP assets in a manner that better reflects cost causality is entirely appropriate.

166. Finally, the Board should order Enbridge to conduct further study of the Double Counting Issue. With the benefit of this additional analysis, the Board and the parties can engage in a more informed discussion about how to best address the Double Counting Issue.

All of which is respectfully submitted this 22nd day of April, 2014.

Original signed by John A.D. Vellone

John A.D. Vellone

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142 Transcript Volume 11 at pg. 15, line 12 to line 20.