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April 22, 2014

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
Suite 2700
2300 Yonge Street
Toronto, ON
M4P 1E4

VIA E-Mail

Dear Ms. Walli:

Re: EB 2012-0459– Enbridge Gas
Final Argument of Vulnerable Energy Consumers Coalition (VECC)

On behalf of Vulnerable Energy Consumers Coalition (VECC), please find enclosed the Final Argument with respect to the above-noted proceeding.

Thank you.

Yours truly,

Michael Janigan
Counsel for VECC

cc: EGDI – Director – Andrew Mandyam – Andrew.mandyam@enbridge.com
EGDI – Counsel – Fred Cass – fcass@airdberlis.com
EGDI – Counsel – Tania Persad – Tania.persad@enbridge.com

All interested parties – EB 2012-0459 - via email

EB-2012-0459

ONTARIO ENERGY BOARD

IN THE MATTER OF the Ontario Energy Board Act, 1998,

S.O. 1998, c. 15, Sched. B, as amended;

AND IN THE MATTER OF an Application by Enbridge Gas

Distribution Inc. for an order or orders approving or fixing

rates for the sale, distribution, transmission and storage of

gas commencing January 1, 2014.

FINAL ARGUMENT OF THE VULNERABLE ENERGY CONSUMERS' COALITION (VECC)

April 22, 2014

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Introduction

The Vulnerable Energy Consumers Coalition VECC) has intervened in this proceeding to secure just and reasonable rates for the membership of its constituent members and to test the validity of the statements contained in the applicant's ("Enbridge", "EGD" "the Company") custom IR application. VECC has been a full participant in this proceeding that has included a technical conference and a settlement conference as well as the oral hearing. For the reasons set out herein VECC does not accept the Applicant's request that its Custom IR proposal be adopted by t the Board. VECC is of the view that an I-X framework should be set for the Company subject to some company-specific provisions.

The Enbridge Custom I.R. Proposal

While Enbridge claims that its Customized IR plan is in keeping with the objectives and guidance provided by the Board's policy statements in the regulation of natural gas and energy, as well international regulatory developments, VECC begs to differ. In VECC's view, the Enbridge plan distorts both the intent and execution of performance based ratemaking models with a view to benefitting the shareholders of the Company, largely by diminishing its business risk. The plan is deficient as a ratemaking framework in at least the six ways which that we will discuss below.

(i) The plan ignores the objective of performance or incentive-based ratemaking.

IRM frameworks were established over the last several decades in many commonwealth countries and the United States, in response to the perceived unhappiness of analysts, regulators and policy makers concerning the propensity of the regulated utility to effect capture of its regulator in a number of significant ways. Firstly, the asymmetries of information favouring the Company meant that Boards and intervening parties had a difficult time challenging the validity of proposed expenditures in cost of service proceedings. This included capital expenses where safety and security of supply claims usually overcame ratepayer concerns about necessity and cost. There was little incentive for the utility to control costs and much more incentive to pad operating and capital costs. Other critics argued that regulation was a product and, as such, subject to supply and demand forces like any commodity. The problem was that the demand was from the stakeholders that were the most enriched by the regulatory process. The groups with the greatest self-interest, in this case the monopoly utilities, create the demand that will be satisfied by the supply because the size of the utilities' economic interest is greater than the more numerous but less engaged ratepayers.

This dissatisfaction sounded in largely two methods of reform – the institution of competition for provision of services heretofore thought to be natural monopolies and the regulation of monopoly utilities in accordance with an objective framework usually in the form of a price or revenue cap that would provide ratepayers with guaranteed productivity benefits and, at the same time, provide a guaranteed window of access to revenue tied to a relevant measure of inflation. This method was usually an I-X formula similar to that in effect in the 2nd generation IRM for Enbridge.

The important thing to note is that the conversion to performance based rate-making from cost of service models was not a simple enhancement of regulatory techniques. In return, for obtaining objective evidence of utility performance and demonstrable benefits from productivity for ratepayers, the new system sacrificed more intensive oversight of utility expenses and control over operations. The tradeoff for the utility was that it had to produce the outcome in rates, but was left relatively unencumbered during IRM periods as to how it achieved the results so long as standards of safety and operability were maintained. Rebasing, together with the productivity or stretch factor built into the revenue or price cap, reaped the benefits of the efficiencies that had been introduced by the Company during the IRM period.

It is true that performance based ratemaking and price caps were not adopted in every jurisdiction for monopoly utility regulation, particularly in utility commissions and boards in a number of states where the supervision associated with cost of service regulation is thought to offer superior protection

Now, Enbridge seeks to change the game again. It wishes to both rebase using its own estimates of operating and capital costs, and building in its own estimate of achievable productivity. It has tried to buttress this effort by questionable benchmarking by expert opinion from Concentric sanctifying the approach. As this argument will demonstrate, the Enbridge proposal combines the aspects of cost of service and incentive ratemaking most favourable to itself and discards restrictions that protect and benefit its ratepayers. What is contemplated in this Custom IR plan is the dismantling of the quid pro quo imposition of an objective inflator such as GDPPI coupled with meaningful productivity expectations in return for the freedom to implement operational efficiencies and to enjoy the financial results of the same during the IRM.

Instead, we have a game that is effectively rigged from the start. The inputs arise, not derived from figures prevailing at the end the previous IRM period, but rather from an exercise wherein EGDI decided to simply reboot the program and then plug in numbers from their own internal estimate of needs. These needs have been qualified by an overall reassurance that the process to determine the proposed revenue requirement has been rigorous because it built in so-called productivity savings that arise from a variety of sources.

These savings mostly arise by the by such techniques as eliminating "variable capital costs" (Argument in Chief (AIC) p.25) - largely the provision for cost overruns and potential future activities, some of which are apparently inevitable ($100 million AIC p.28). The Company is presumably content to wait for rebasing following the term of the IRM to roll such costs into rate base happily pocketing revenue for such growth as the new capital projects may permit. In addition, it not only requests consideration of extraordinary capital items in rate base , primary of the extensions and relocations variety, it eschews traditional reliance on the inflation factor in the I-X formula to incorporate its own estimates of how the ROE will increase during the term of the IRM.

To ostensibly mollify objections of cherry picking trouble spots. we have assurances that as a result of models developed in the first half of 2013 (p.46), the Company proceeded to limit the first budgetary requests of department managers to about 2.24% as recommended by Concentric (AIC, p. 46). As the Company witness, Mr. Lister notes (Tr. Vol. 2, p.33), Enbridge relied on Concentric's Mr. Coyne for reasonable I and X values in rejecting the standard model. As VECC's argument will submit later, Mr. Coyne's evidence is fraught with difficulties, challenging the validity of Enbridge's assumptions in developing its "building block model".

While measures such as holding FTEs flat (AIC p.46) may control some costs, recovery of 2.2% of an estimated 3% labour costs and 6.1% increase in benefits is hardly reassuring from a cost control standpoint. While the usual consequences of customer growth in a utility is to drive the costs of serving an individual customer down, robust customer growth (1.7% to 1.8% -AIC p. 49) is treated simply as creating obligations rather than as a revenue enhancement opportunity. And while much is made of the increase in the Other O&M budget in the 2013 actuals over the Board approved, the fact is that Enbridge recovered over $30 million in revenue over its allowed rate of return. This is hardly surprising given absolute consistency with which Enbridge has earned its normalized rate of return since 1985 (Tr.Vol.2 p. 29).

Enbridge wants the freedom to control its costs in an IRM framework over the next 4 years (and continue its historic pattern of over-earning), while at the same getting assurance that ratepayers will insulate the Company from making hard decisions to control expenditures.

While VECC proposes to drill down in certain issue areas of the Enbridge Custom IR later in this argument, there are several general submissions that we wish to make on the suitability of the proposal for the purpose of an IRM framework.

(ii) There is insufficient evidentiary base for departure from IRM formula

To justify its rejection of standard I-X formula for an IRM plan, Enbridge has dragged in a laundry list of expenditures that it clearly does not wish to arrange its business plan to meet. Some costs such as the capital spending associated with the Board approved GTA reinforcement project, the Ottawa extension and the WAMs project seem appropriate to be considered as Y factors in a Custom IR scheme. Ex B2-1-1reproduced at p. 22 of the AIC appears to make that case notwithstanding its reproduction in the AIC. VECC submits that these projects are not evidence that the I-X formula doesn't fit the Company, rather that there may be grounds to provide for the relevant exception. As Ex. B2-1-1 shows and the AIC notes, the core capital requirements of the Company actually decline in relation to anticipated inflation, making the need for an escape from an I-X plan dubious at best. Given that its capital needs are the principal driver for the plan, (Tr. Vol. 2, p.26, this seems to be a rather important point.

> "(Mr. Lister) And I think, quite simply, what we're saying is that an I-X regime, given the capital spending requirements of the business -- and there will be a capital panel who will be happy to address all of those requirements in great detail if you wish -- given those capital spending requirements, mathematically an I-X outcome couldn't provide the utility an opportunity to earn a fair return."

In turn, Enbridge conflates the difficult fit of the special capital projects mentioned above with its capital plan in an I-X framework with its O&M budget which seemingly cannot be reasonably contained within such a framework. The purpose of using an inflator such as GDPPI is to ensure that ratepayers do not have to bear increases in expenses that are not in keeping with prevailing conditions in the economy. There can be little argument that Enbridge is of a size where it should be able to accommodate transitory price increases in one area of its operations with efficiencies in another. As well, where there are decisions to be made that lock in percentage expense increases well above a reasonable inflator such as GDDPI in the labour area, the Company must make provision by way of efficiencies elsewhere. The Board noted on Hydro Ottawa Decision EB 2011-0054 p.13:

> "It is the Board's expectation that costs be contained as a whole and where there is little the company can do to control costs in some areas it must make up for it in areas where it does have control."

Enbridge tries to buttress its case by offering the opinion of Mr. Coyne of Concentric Consulting Associates that Enbridge's metrics in terms of O&M per customer. As will be noted elsewhere in this argument, Mr. Coyne's assurances of efficient Company operations through his benchmarking studies are suspect.

(iii) Improper use of RRFE principles to justify plan

One of the pillars of the Company's case for its custom IR is its efforts to situate Enbridge in the same position as municipal electric distribution companies whose regulatory framework was addressed in the Report of the Board "Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach" , released in October 2012. While the Board's report did set out a path for electricity distribution companies with large and variable capital requirements to have their needs met, it is highly questionable whether the Board wished to extend the same treatment to the natural gas distribution industry which is experienced in the regulatory process and whose needs are different than the range of electrics that require urgent attention to infrastructure needs. VECC finds it instructive that while its AIC claims that its Custom IR has direct support from the RRFE Report (AIC, p;. 16), it makes no mention of whether its Custom IR fulfills the first two objectives of the Board's Report adopted from sec 1(1) of the *OEB Act*:

1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.

2. To promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.

Essentially, Enbridge has designed a framework that caters to virtually one value - ensuring that the Company can earn its rate of return. Any other goal takes a back seat to that objective so that concepts like acceptable productivity targets and reasonable limits on capital additions fall in line with its business plan.

(iv) Comparison to Union scheme –implications for ratepayers

During the Oral Hearing, SEC produced Exhibit K1.3 in an attempt to compare what EGD would get under Union's approved IRM with the relief that EGD was seeking.

To this end, SEC removed Pension and SRC costs from revenue at existing rates and then inflated the non-Y factor component of this revenue by 1.70% per year to adjust for customer growth and calculated the revenue adjusted for customer growth for each year of the plan, including the Y-factor revenue unadjusted for growth.

Then, as the Y-factor components of revenue would not be escalated by an (I-X) approach, SEC removed the Y-factor component in the revenue requirement and applied Union's (I-X) escalator to the non-Y-factor revenue requirement, escalating this component by 0.8% under the assumption that inflation would be 2%, with the X-factor offsetting 60% of the inflation.

Then, the Y-factor component of revenue was added back in to get escalated revenues for EGD under Union's approved plan.

The result of SEC's modeling of "EGD under Union's IR plan" was a cumulative increase in revenues over five years of $613M.

SEC then took EGD's proposal as filed, removed the impacts of SRC and Pension impacts, and calculated the comparable cumulative increase in EGD's request as $947M.

The conclusion is that EGD is seeking $333M more in revenues than it would get if it operated under the Union (I-X) approved mechanism after appropriate adjustments: almost 50% more, all funded by ratepayers.

VECC believes that the increase sought under EGD's 5-year forecast plan is not supported or supportable by the evidence.

(v) **Methodologically unsound expert analysis –benchmarking etc.**

The expert evidence in this proceeding has been offered on the subject of the design of the appropriate IRM and benchmarking the results of Enbridge operations against other comparable natural gas distribution companies.

Before dealing with the substance of what has been found and recommended, it is instructive to compare the experience of Board Staff expert Dr. Lawrence Kaufman with Enbridge's Mr. James Coyne. As his resume demonstrates, Dr. Kaufman, has advised Boards and Commissions on numerous occasions on

PBR and benchmarking, key elements in devising an incentive model to generate just and reasonable rates.

Exhibit 1.5 shows and extensive range of consulting projects, policy papers, publications and refereed journal articles and testimony in this field. There are some 38 instances where expert witness testimony was given by Dr. Kaufman before Boards and Commissions in Canada, the United States and New Zealand, primarily on issues intimately bound up with determinations to be made by the Board in this proceeding and ultimately the potential adoption of the Enbridge Custom IR plan. Mr. Coyne on the other hand has a resume that demonstrates a familiarity with the a constellation of issues pertaining to the energy industry but little indication of the kind of specialized knowledge in the area of performance based ratemaking and company analysis based on benchmarking of comparable. As Mr. Coyne shows in his curriculum vitae resurrected from a Regie proceeding, he has had an extraordinarily limited experience in the issue area relevant to the suitability of the custom IR proposal. Exhibit 4.1 reveals that Mr. Coyne's experience, prior to this case in incentive based ratemaking has been limited to providing regulatory support to Gas Metro in 2011 in evaluating a mechanism arising from a stakeholder working group, support work for Hydro Quebec, and expert testimony offered in 2006 for Vermont Gas Systems before the Vermont Public Service Board in a case that was eventually determined in accordance with a settlement agreement (Tr. Vol. 4,p.9) This is the first case in which his testimony on the range of issues providing the foundation for Enbridge's Custom IR proposal will be decided by a board or tribunal. As his cv demonstrates, Mr. Coyne has claimed expertise in issues as varied such as cost of capital, demand side management and now incentive based rate-making. Mr. Coyne does not, or has not published in refereed journals.

There may well be merit in soliciting the views from a generalist such as Mr. Coyne on trends within the industry, and the range of solutions taken up by industry players and boards throughout North America. However, VECC respectfully suggests on matters of judgment as to the effectiveness of proposed incentives, the correct components for an IRM framework and the benchmarking of utility performance, that it would be exceedingly risky to rely on Mr. Coyne's evidence and testimony This is particularly the case given the Board panel's cautionary note set out on p. Vol. 3 pp. 42, 43 of the transcript.

On the other side of the coin, Dr. Kaufman's findings are devastating to the central thrust of the Coyne Concentric report. He is critical of the building block theory of incentive based ratemaking largely because, as VECC has noted above, it lands the regulator back in the same place it was in prior to initiating alternative ratemaking. He states on p. 2 of his report (Ex.L T1S2)

> "EGD says its Customized IR proposal is an example of "building block" regulation, but it is a version of building blocks that the UK energy regulator abandoned nearly a decade ago because of its poor incentive properties. The EGD's Customized IR proposal creates the same perverse ex ante incentives to inflate capital cost projections as the early UK building block plans. Because the Company's capital expenditure forecasts are not supported by independent and external benchmarking evidence, the inherent incentive to inflate these forecasts under the Customized IR proposal can generate unreasonably high prices and shift risks to customers."

As we have noted earlier, the propensity for Enbridge to put the cart before the horse, as it were, by according Enbridge's risk avoidance or shifting activity the first priority in any IRM arrangement has the effect of CEA and, ultimately the Company, spouting self-serving theories about future operations as if they were well accepted facts. On page 3 of his report Dr. Kaufman notes:

> "Whenever CEA finds revenues under a potential rate adjustment formula are below EGD's costs, it concludes that the rate adjustment formula is inappropriate, not the cost levels reflected in the Customized IR proposal. CEA is therefore using the Company's cost proposals to "benchmark" the reasonableness of IR rate adjustment formulas, not the other way around."

As the cross-examination and testimonial exchanges between the experts showed, the choice of comparable utilities for benchmarks for Enbridge's performance has likely been skewed by Mr. Coyne's choice of determinants for aggregation purposes including weather.

In any event, both CEA's Mr. Coyne and Dr. Kauffman agree that Enbridge's performance in terms of capital cost per customer does not give it any leadership status among gas utilities. In fact, as Dr. Kaufman notes, on page 38 of his report, that using CEA's own figures suggest that:

> "EGD's total costs per customer are actually greater than the total costs per customer of the study group."

In that the projected capital costs are the admitted driver of this application, it seems odd from a regulatory standpoint that the request is for the Company's appetite for capital expansion should be largely sated through its Custom IR.

As we have noted above, there is little credibility in the theoretical construct that is sought to be established by the risk-mitigating objectives of the Company and the parroting support of CEA. In VECC's view, this custom IR is another version of the effort of the Company, combined with supportive evidence from CEA ,to achieve a thickening of its equity component of its cost of capital two years ago. In the latter case, efforts were made by CEA to inflate he business risk of the Company using much the same evidence of risk that the Company would not be able to earn its allowed rate of return. The Board rightly rejected that evidence in its decision in EB 2011-0354. As much as the Company witness panel denies it (Tr. p. 26), this custom IR's risk mitigation effect has the appearance of attempting to obtain through the back door what could not be obtained through the front.

The Company disingenuously suggests that no evidence supporting an alternative model to the Enbridge Custom IR plan has been presented so there is no evidence upon which an alternate plan can be approved (AIC, p. 20). Clearly, if the Board finds, as we have suggested that the Custom IR plan is fanciful and one-sided, it can put in place a plan to generate just and reasonable rates for such period as may be thought appropriate. In this matter, VECC repeats and adopts the relevant portions of SEC's argument on this subject. There is plenty of evidence on the record associated with both the Board's acceptance of the Union IRM plan, as well as the results of the Company's second generation IRM plan that generated efficiencies (Dr. Kaufman, p.5) as well allowed the Company to meet its normalized rate of return. Enbridge has the outlier plan and can't sanctify their self-serving proposal by suggesting it is an all or nothing acceptance required.

(vi) Still possible to design IRM scheme that corresponds to IRM objectives

VECC's position is that given a few adjustments to EGD's proposals, the Board could approve an IR plan for Enbridge for setting rates under a variant of the (I-X) plan the Board has approved recently for Union.

The first step would be to determine whether 2014 base rates are appropriate as proposed or whether adjustments are required.

VECC's view is that the Board should consider an adjustment to reflect 2013 over-earnings.

The Board could also consider, either inside or outside the (I-X) cap, adjustment to reflect the treatment of SRCs similarly to the Board's treatment of deferred taxes, i.e., draw down the very large accumulated balance, front-end loaded, over a period of time and thereafter collect forecasted current period amounts only. In VECC's view, it would be simpler to adjust for the drawdown outside of expenses subject to the (I-X) cap.

Further, for 2014, to address EGD's concern with the problem of financing very large, lumpy capital expenditures related to the GTA Project and the Ottawa Project, the related capital expenditures should be accorded Y-factor treatment leaving only costs associated with core capital expenditures in the revenue to be inflated by the (I-X) escalator.

Given that VECC is unaware of any material reasons as to why, given this Y-factor protection for large capital projects, EGD could not operate successfully under the same (I-X) parameters (i.e., I determined by GDPIPI and X set at 60% of I) as were approved for Union. VECC submits that there is sufficient evidence on the record for the Board to make such a finding.

Should the Board not be amenable to approving a Union-type IRM on EGD there are a number of alternatives available to the Board. While VECC will not here attempt to provide a comprehensive list of such alternatives, one possibility that appears to have merit would be for the Board to set rates in this proceeding for 2014 (or for 2014-2015).

<u>The Enbridge Proposal – Some Specifics</u>

1. Capital Spending Needs and Cost Drivers

VECC notes that EGD has removed the WAMS component of capital spending; VECC further notes that CIS related expenditures are proposed to be treated as a Y-factor. VECC agrees that this treatment is appropriate.

EGD has argued that the reason that it cannot operate under an (I-X) plan as has been approved for Union is the large capital expenditures related to the GTA Project and the Ottawa Project: VECC notes that EGD does not contend that it cannot operate if these capital expenditures were treated as Y-factors, which is how VECC recommends they be treated. It is also hard to see why the Company regards such adjustments as introducing too much complexity (Tr. Vol. 2 p.32) given the relatively cumbersome process involved in the method actually chosen.

Once the WAMS, CIS, and GTA and Ottawa Projects are removed from the capped amounts, there is no reason known to VECC as to why the Union (I-X) approach would not work for EGD since the only capital spending remaining under the cap would be core capital expenditures that are fairly flat for the period 2014-2018 at about $450M each year.

In VECC's view, it is not appropriate to conclude that because there are large lumpy investments you cannot apply (I-X) to <u>any</u> revenue component: rather, the appropriate conclusion is that these large lumpy investments should properly be treated separately as Y-factors with remaining capital and O&M revenue requirements being "under the cap."

2. Cost of Capital

The company has proposed that unlike the standard incentive ratemaking framework, that its ROE not be governed by an external measurement of costs and that it increase in each year of the plan based on an estimate of where long term Canada bonds and corporate bond rates may be at the annual date for setting the same. VECC has noted elsewhere in this argument the one-sided aspect of both allowing capital expenses to slip outside an IRM I-X metric and then have them part of an escalating ROE during the term.

VECC has had the advantage of reviewing the Board staff position on the floating ROE and concurs with both the analysis and the conclusion therein on page 46 of the Board Staff argument:

> "Finally, Board staff observes that the Union Gas 2014-2018 IR settlement agreement has a frozen ROE at 8.93% for the term of the plan. Noteworthy also, is that the settlement established the ROE for the purposes of sharing earnings at the same (i.e. the Enbridge 2013

approved) level of 8.93%.[89] Board staff suggests that the Board adopt this same approach for earnings sharing at Enbridge, to avoid any confusion over what the level of ROE is for that purpose."

3. Operations and Maintenance Expense

As the Board staff argument notes it the Other O&M expense category that is substantially the contested issue in the area of costs. VECC is not impressed with the seeming impotence on the part of the Company to deal with costs that are at least influenced by their business plan and certainly might be lessened in the manner suggested by the Board in the Hydro Ottawa decision referenced above. This exposes yet another weakness in the "building blocks" approach to IRM, in that the Board is asked to effectively increase this part of the budget and at the same time be reassured that because the Company's O&M costs per customer are going down so that it is controlling costs. In fact as Table 9 in EGD's evidence, (explored with the Company witness panel at Vol7 p.50) demonstrates, the decline in cost per customer is very much tied in with customer growth. It can be observed from the table that the decline is almost exclusively due to the cost per customer declining in accordance with monopoly economics.

VECC submits that the Company may well have cost pressures in different segments of its operations. The merits of the envelope I-X approach are that the Company, not the Board, can make the key allocation decisions. VECC urges that the Board not depart from the framework set out for Union Gas in fashioning its framework for Enbridge.

4. **Site Restoration Costs**

References: D1-5-1, D2-1-1, Transcript Day 9 – will add specifics for later version.

(a) Background

Enbridge has been pre-collecting, in rates, the future costs of asset retirements or removals and land restoration upon asset removals, i.e., site restoration costs or SRCs, in rates using a method for calculating such costs that it calls the "Traditional Method." According to GF, this method is used by most North American analysts, including the analysts who prepared Union Gas Limited's recent depreciation study.

GF claims that the main driver of actual retirement costs is labour costs: as such, any estimate of future removal costs must include an estimate of future inflation.

As a general principle, EGD contends that the regulatory concept of generational equity requires that those who benefit from assets in-service should be responsible for the costs of these assets – including the retirement costs. As such, EGD asserts that these retirement costs should be collected over the expected life of the relevant assets. (D1-5-1, page 3) VECC agrees with this statement of principle.

Pursuant to the Settlement Agreement in EGD's 2013 rates case (EB-2011-0354), EGD agreed to extend the period over which certain distribution assets (mains and services and meters) had been depreciated. (D1-5-1).

At December 31, 2010, EGD had a balance of $723.9M on its financial statements related to its future SRC liabilities. While this reserve balance would be drawn down in the future as assets are retired by the actual retirement costs, the reserve would be increased by amounts collected in rates for SRCs.

Given that the SRC reserve is intended to recover the SRCs of all assets in service whereas, annually, EGD only retires a small percentage of assets in service and given the increasing use of longer-lived assets (e.g., plastic pipe), the SRC balance is not only large but also growing at a fast rate under EGD's traditional treatment of SRCs.

(b) EGD Proposal

In November, 2012, EGD engaged Gannett Fleming (GF) to conduct a Net Salvage Study of EGD's SRC funding requirements and to investigate alternative approaches to meet these requirements. The GF study was filed with the pre-filed evidence at D2-1-1.

In the first phase, the GF study found that EGD's net salvage percentages were: (i) larger in magnitude ("more negative") than the percentages at comparable utilities, largely due to the expected remaining lives of certain assets and (ii) were larger than appropriate due to the embedding of the high inflation experienced in the early 1980s.

A net salvage percentage that is "too negative" will result in over-collecting SRCs from ratepayers and this, along with the overall size of EGD's reserve, led to an examination, in the second phase of the study, as to how to appropriately address the issue of a "too large" and growing SRC reserve.

GF found that the SRC accumulated balance was $292.8M in excess of EGD's funding requirements and explored alternative methods of reducing the SRC balance in Phase 2 of its study.

In the second phase, GF considered three alternative approaches to address the SRC issue: (i) the "Pause Method" under which EGD would suspend recovering monies from ratepayers for SRC purposes while the reserve balance was drawn down; (ii) the "Adjustment Method" under which EGD would apply different net salvage percentages to the original cost of in-service assets based for each installation vintage; and (iii) the "Constant Dollar Net Salvage Method" (CDNS) which, in VECC's understanding, involves restating both historic salvage costs and original asset costs in current dollars (so as to provide "apples to apples" equivalence), using the estimated service life and forecasted future inflation to find the future nominal salvage cost at the expected time of asset retirement, and finally discounting the future nominal expected cost to a current cost using an appropriate discount factor (long Canada bonds) to reflect the time value of money.

GF rejected the Pause Method due to concerns over possible post-pause rate shock and considerations of intergenerational equity.

GF rejected the Adjustment Method because, in its view, the adjusted net salvage percentages would not be significantly different from the current percentages and, as such, would not materially address the problem of a too-large-and-growing SRC reserve.

GF recommended the third method, the CDNS approach, to be adopted by EGD asserting that it would produce more accurate estimates of SRC funding requirements than does the current Traditional Method citing two advantages of switching to its preferred CDNS methodology:

(i) CDNS uses a strictly forward looking forecast of future inflation rather than embedding historical inflation rates as does the Traditional Method; and

(ii) Under CDNS, the comparison of current removal costs to currently budgeted projects is directly on a current dollar, apples-to-apples basis, unlike the Traditional Method which requires material adjustment for such a comparison.

(c) VECC position

VECC notes that two other possible approaches to the treatment of SRC were discussed at the Oral hearing, namely (i) treating them under USGAAP by creating a liability in the form of an Asset Retirement Obligation (ARO) and an offsetting asset in the form of an Asset Retirement Cost (ARC), and (ii) treating the related costs as current expenses.

With respect to ARC/ARO treatment under USGAAP, while VECC notes that OPG uses this accounting treatment in its regulatory framework, the testimony of EGD is that, notwithstanding that it has adopted USGAAP, EGD asserted that it does not use ARC/ARO treatment for its SRC for two reasons: (i) EGD is not legally required to clean up sites after abandonment and (ii) since the utility has an obligation to serve, it will not be abandoning any sites for the foreseeable future, the discounted present value of any such costs will be immaterial.

Concerning this alternative VECC makes one comment: if a utility were in a steady state (maintaining rate base, replacing assets of a given type every T years, constant time value of money, constant inflation rate) from now and indefinitely into the future, the present value of the infinite number of replacements at regular intervals for any class of assets would be finite as long as the time value of money (discount rate) exceeds the inflation rate. However, VECC notes that EGD is not in any such steady state as it is a growing utility in terms of customers and rate base.

VECC will address the current expense treatment in its recommendations.

As noted above, at the end of 2010, the SRC reserve stood at $723.9M: the fund has since increased to $905M at the end of 2013. (Day 9, page 33, J1.1)

To address GF's finding that the SRC balance was in excess of requirements by $292.8M, EGD proposed a going forward reduction in depreciation rates (per its CDNS) proposal along with a front end loaded rate rider credit for ratepayers over the years 2014-2018.

With respect to the SRC issue, EGD proposes to reduce future collections by \$6.6M per year, totaling a \$33M reduction over 2014-2018, by a reduction in depreciation charges collected in "allowed revenues" (i.e., rates); the remainder of the \$292.8M total excess, \$259.8M, would be credited to customers through a rate rider "outside of allowed revenues."

VECC notes that while the total of these two credits does total \$292.8M, the revenue requirement impacts differ due to changes in rate base and tax impacts. Furthermore, under EGD's proposals the SRC balance at the end of 2018 will not be anywhere close to \$292M below its current balance.

(d) Impacts of EGD's Proposal

The impacts on revenues of are provided in Exhibit K9.1.

The "outside allowed revenues" impact of the rate rider return is straightforward, a cumulative return of \$259.8M that is frontloaded, decreasing annually over the five-year term 2014-2018. While not accepting EGD's proposals on the SRC, VECC does support that any substantial refund to ratepayers to correct EGD's historic over-collections of SRCs should be frontloaded to reduce any potential rate shock implications once the refunds to ratepayers ends.

The rate rider also has impacts on "within allowed revenues" (revenue requirement) due to the attendant reduction in accumulated depreciation increasing rate base and therefore increasing the carrying costs of rate base, and due to the tax impacts of increasing deductions (rate rider payouts) from taxable income and thereby reducing the revenue requirement. "Within allowed revenues" is also decreased by EGD's proposal to reduce depreciation costs by \$6.6M per year.

The total impact on the revenue requirement for the period 2014-2018 is a cumulative $241.4M reduction.

(e) VECC Recommendations

In VECC's view (and EGD's view), EGD has substantially over-collected in respect of SRCs resulting in a very large and growing reserve fund: the fund is far larger than required and is growing.

VECC notes that if a utility is continually recovering amounts from ratepayers that exceed costs incurred, the cumulative balance of any such over-collections must grow over time: the appropriate remedy with respect to recoveries from ratepayers should be to align recoveries with actual costs.

VECC notes that during the oral hearing, EGD stated that its "net salvage value" charged in depreciation a rate is $50M-$60M per year and that this amount exceeds the amount spent on asset retirements in any year. (Day 9, page 34). While EGD's witness stated that if you are recovering amounts for both current costs and future costs then current recoveries would always exceed current costs, in VECC's view it is inappropriate to collect $50-$60M per year when actual historical costs have been much smaller: according to E40 Staff IR 77, over the 10-year period 2009-2018, the total expected removal costs are $197.7M for an annual average of $19.77M.

Further, VECC notes that under EGD's proposal, the expected SRC reserve balance will be $815.1M at the end of 2018 (E40 Staff 77): in VECC's view, this balance, the equivalent of funding more than 40 years of actual restoration costs, is vastly in excess of any current or foreseeable funding requirements, invokes intergenerational inequity on its own.

In VECC's view, there is some similarity between the SRC funding issue and the regulatory treatment of deferred taxes: in both cases, collections exceeded expenses for a prolonged period of time and, in both cases, the prospect of ever requiring the amounts collected are dim to nil for the case of a growing utility.

VECC submits that an appropriate treatment for the excess SRC balance is therefore to draw it down to a more appropriate balance by providing ratepayers with a phased, front-end loaded offset to the revenue requirement and, going forward, including in the revenue requirement the current period expected expenses for restoration costs. This would result in rate base changes (through the drawing down of accumulated depreciation) and the attendant increase in rate base carrying costs in allowed revenue along with reductions in the allowed revenue in each year to reflect the drawdown offset and the lower future depreciation charges which should ultimately only reflect expected period costs as long as the utility is growing.

With respect to any proposal approved by the Board, VECC urges that for any present value calculations required to implement such proposal, the discount rate should involve a risk-free rate plus a risk premium appropriate for the utility: in VECC's view the use of a risk free rate alone, as employed by EGD, is inappropriate on its face and serves only to inflate the present value of future costs unduly.

Regarding specifics, SEC has shared a draft of its argument in respect of the SRC issue and, in VECC's view, the elements proposed by SEC in terms of related base year adjustments, phased refunds to customers, reducing the reserve balance, and the treatment of replacement/retirement expenses as current expenses are appropriate.

VECC supports SEC's submissions on this issue.

6. Plan Features – Z Factors, SEIM, ESM

a) Z-Factors

VECC has had the opportunity to review the comments of Board staff concerning the proposed language for the z factor in the Enbridge proposal. VECC agrees with the Board staff position (Bd. Staff. Argument p.39) adopting the evidence of Dr. Kaufman criticizing the substitution of the word "cause" for the term "event" as the trigger for the z factor analysis of responsibility. As well, there appears to be little reason to lower the materiality threshold from$ 4 million to the Company proposed$ 1.5Million given the Union precedent and low risk of the Applicant. With those changes, VECC can approve the adoption of the z factor.

b) SEIM

One issue that arises in real incentive regulation plans is that towards the end of the plan as a utility faces rebasing, the utility has an incentive to increase spending and defer cost reductions that, otherwise, might have been pursued by the utility: this may occur due to a desire by the utility to increase RoE during the IR plan term, to pad costs, capital and operating, during the subsequent rebasing prior to entering the next generation IR plan, or for other reasons such as incurring costs during the IR term for which the utility is not compensated fully. While VECC agrees there is latitude for a utility gaming the regulatory construct to its advantage, VECC cannot support EGD's attempt to address this issue by its SEIM proposal.(The relevant EGD panel had never known it to occur- Tr. Vol. 7, p.52)

EGD's proposed SEIM scheme involves the following elements: an extra payment of up to 0.5% RoE based on the 5-year average difference between actual RoE and approved RoE during the plan, available for two years following the plan, subject to EGD providing an NPV analysis illustrating that the net discounted benefits to ratepayers exceeds the EGD payout.

VECC takes issue with a number of components of this proposal.
First, basing the SEIM payment on the average excess earned over the five year term of the plan does not discriminate between early years or later years of the plan.

Second, the RoE could easily exceed the approved RoE for any number of reasons, not the least of which, is the utility putting considerable "headroom" in its capital and O&M spending forecasts which may not be all weeded out in the regulatory process. On this, VECC notes that it is unaware of any year in recent history in which EGD, on a normalized basis, has failed to earn the Board approved RoE regardless of the regulatory regime under which EGD's rates were set. Further, there is ample evidence in this proceeding that EGD's base rates need to be lowered significantly in the first year of any plan approved by the Board – a situation leading to a very plausible outcome of over-earning throughout the plan unless significant adjustments are made to base rates – something that may or may not occur.

To EGD's claim that it will justify any SEIM claim based on an NPV analysis extending into the future, VECC believes that there may be over-earning unrelated to productivity initiatives that could be "rebranded" afterwards with a narrative attributing said over-earning to productivity improvements after the fact.

VECC's view is that any such support for a SEIM claim – which would be after the fact – would be subjective, may not be reflective of real benefits for ratepayers, and, even if it does so initially, might not deliver any benefits to ratepayers a few years hence as per the provided NPV analysis if the alleged supporting initiative were to be modified or revised after the SEIM payment is secured.

In summary, VECC views the SEIM proposal as an attempt to appropriate monies to which the utility may not otherwise be entitled, getting more because they earned more regardless as to the reason for overearning and, as such inappropriate and unworthy of approval.

(c) ESM

VECC has reviewed the submission of Energy Probe on this issue and endorses both the analysis contained therein and the recommendations. It is VECC's belief that design of the ESM proposed by Energy Probe will create greater incentive for efficiencies and increase the likelihood that ratepayers will share in the benefits of the Company overearning.

Costs

The Vulnerable Energy Consumers Coalition (VECC) hereby requests that the Board order payment of its reasonably incurred costs in connection with its participation in this proceeding. It is submitted that VECC has participated responsibly throughout, and arranged its representation with other intervenor stakeholders in a way to reduce unnecessary costs and provide assistance to the Board.