PETER C.P. THOMPSON, Q.C.
T 613.787.3528
pthompson@blg.com

Borden Ladner Gervais LLP
World Exchange Plaza
100 Queen St, Suite 1300
Ottawa, ON, Canada K1P 1J9
T 613.237.5160
F 613.230.8842
blg.com

Borden Ladner Gervais

By electronic filing

April 22, 2014

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

Dear Ms Walli,

Enbridge Gas Distribution Inc. ("EGD") 2014 to 2018 Rates Application	
Board File No.:	**EB-2012-0459**
Our File No.:	**339583-000165**

We are enclosing the Written Argument of Canadian Manufacturers & Exporters ("CME") in connection with this matter.

Unfortunately, some evidence references have yet to added to the document. In large measure, these references will duplicate those contained in others' submissions.

Personal circumstances preclude me from adding these references tonight. They will be included in a follow-up version of this submission which we will deliver tomorrow.

Yours very truly,

Peter C.P. Thompson, Q.C.

PCT\slc
enclosure
c. Norm Ryckman (EGD)
Fred Cass (Aird & Berlis)
Intervenors EB-2012-0459
Paul Clipsham (CME)

OTT01: 6281358: v1

EB-2012-0459

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

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

ARGUMENT OF CANADIAN MANUFACTURERS & EXPORTERS ("CME")

April 22, 2014

Peter C.P. Thompson, Q.C.
Vincent J. DeRose
Kim Dullet
Borden Ladner Gervais LLP
World Exchange Plaza
100 Queen Street
Suite 1300
Ottawa, ON K1P 1J9

Counsel for CME

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I. INTRODUCTION & OVERVIEW

1. Enbridge Gas Distribution Inc. ("EGD") seeks approvals for a proposed rate-setting framework for the 5 year period commencing January 1, 2014. Its proposal is based on revenue requirements for each of the years 2014 to 2018 derived from forecasts for each of those years of Rate Base, Cost of Capital, Revenues and Cost of Service.

2. Despite its Cost of Service ("COS") format, EGD characterizes its proposal as a Customized Incentive Regulation ("IR") Plan. EGD contends that its proposed plan is compatible with the Ontario Energy Board's (the "Board" or "OEB") current incentive rate-making policy because it is analogous to the Custom IR rate-setting method described in the Board's October 18, 2012 Report entitled "Renewed Regulatory Framework for Electricity Distributors: A Performance Based Approach" (the "RRFE Report").

3. Within the ambit of EGD's so-called multi-year incentive plan are proposals to remediate what EGD has identified as an over-collection from ratepayers of Site Restoration Costs ("SRC"). These costs represent amounts collected as part of depreciation charged on property, plant and equipment to fund future costs for removal and site restoration relating thereto. The accumulated unfunded liability to December 31, 2013, for amounts collected for SRC, but not spent, is some $905M according to EGD's consolidated Financial Statements for that period.

4. Using a changed method for calculating amounts to be recovered for SRC, EGD's advisers opine that the SRC reserve as of December 31, 2010, was excessive by about $292.8M. EGD proposes to refund this amount to ratepayers over the 5 years from January 1, 2014 to December 31, 2018 by means of a combination of a rate-rider to provide $259.8M to ratepayers and $6.6M per year or $33M for 5 years by means of a refund-related reduction in the depreciation rates in that 5 year period.

5. In addition to the refund amount of $292.8M, EGD proposes, on a go-forward basis commencing January 1, 2014, to reduce the amount of SRC being collected from ratepayers through depreciation rates. However, the lower amount of SRC costs which EGD proposes to recover, over the 5 years, of about $247.3M, still exceeds the SRC it expects to incur in that period of $76.4M by $170.9M or, on average, by about $34M per year.

6. These submissions will address the SRC issues as matters unrelated to issues pertaining to the appropriateness of EGD's multi-year incentive rate-making proposal. The thrust of our submissions with respect to the SRC issues is that EGD's calculation of the amount to be refunded over the 5 year period 2014 to 2018 is too low, and the amounts it is proposing to collect in rates on a go-forward basis commencing January 1, 2014, are too high.

7. Excluding matters related to the SRC issues and with Y Factors held constant, the cumulative delivery revenue requirement EGD seeks to recover from ratepayers for the years 2014 to 2018 under the auspices of its so-called Customized IR Plan is estimated to be slightly in excess of $6B. This amount is estimated to be some $899M, or on average, $180M per year, above the annual revenue requirement currently being recovered in Board approved rates for 5 years before any adjustment for customer growth. With an adjustment for anticipated customer growth in the period 2014 to 2018, the cumulative 5 year increase in revenue requirement EGD asks the Board to approve is estimated to be some $676M or on average, an increase in revenue requirement of about $135M per year. These amounts stem from calculations prepared by counsel for the School Energy Coalition ("SEC"), which EGD's witnesses accepted as reasonable.

8. Excluding SRC impacts and Y Factor adjustments, the cumulative delivery revenue requirements over the years 2014 which EGD is asking the Board to approve exceed by more than $330M (or on average, $66M per year), the cumulative delivery revenue requirement EGD would recover if the Incentive Regulation Mechanism ("IRM") which the Board recently approved for Union Gas Limited ("Union") is applied to EGD.

9. The fact that EGD is seeking approval for an IR Plan which will provide it with some $66M more per annum than the application, to EGD, of the Board approved IRM Plan for Union would produce should prompt the Board to scrutinize EGD's proposal with considerable diligence.

10. The purpose of the Board's incentive rate-making policies is to reward those utilities who perform to a level which meets or exceeds best in class standards or benchmarks used in the derivation of incentive-based rates, but to refrain from providing such incentive rewards to utilities who fail to meet such standards. EGD is effectively requesting that its 2014 to 2018 delivery rates be set at levels far higher than those of Union, despite the absence of any convincing demonstration by EGD that the cost and other pressures it

faces over the period 2014 to 2018 are materially different from the cost and other pressures Union faces.

11. Many customers of EGD are already concerned with the recent 40% increase in EGD's gas costs compared to the materially lower percentage increase in such costs for Union. That unsatisfactory outcome should not be compounded by an approval for a so-called Customized IR Plan for EGD which produces increases in its delivery rates over the period 2014 to 2018 far in excess of the increases in delivery rates which the Board has already approved for Union.

12. An item of considerable importance, which should be addressed at the outset of the Board's consideration of EGD's proposal, is the issue of onus. In its application, the presentation of its evidence, and its Argument-in-Chief, EGD effectively assumes that its internally derived forecasts of need, for each of the years 2014 to 2018, but wholly unsupported by adequate externally derived benchmarks and standards, are the "circumstances" which determine the format of the IR Plan to be used in determining its incentive based rates. At page 8 of its Argument-in-Chief, EGD states as follows:

> *Enbridge submits that there is no principled or logical basis for an expectation that, over a five year term, Enbridge should live with a particular form of IR, such as an I Minus X model, without clearly showing that such a model will be able to satisfactorily manage Enbridge's circumstances. The Board has recognized in the RRFE report that the Custom IR rate-setting method for electricity distributors is intended to be customized to fit the specific applicant's circumstances*[1]*. Enbridge submits that it is equally the case for a natural gas distributor that, rather than attempting to "force-fit" a particular model without regard to the circumstances of the utility, the Board can and should consider what model is best-suited to "the specific applicant's circumstances".*

At page 20 of its Argument-in-Chief, EGD states:

> *It must be noted as well that no evidence has been filed by any party in support of an alternative model to the Customized IR plan and there is no evidentiary base upon which the Board could conclude that another model is more appropriate for Enbridge's circumstances that the proposed plan.*

13. We submit that in these passages, EGD misinterprets the RRFE Report in failing to recognize the limits of the Custom IR Model described therein and disregards the pre-

[1] RRFE Report, at pp.18-19.

requisites to be established to justify the approval of an IR Plan presented under the auspices of that rate-setting method.

14. As a matter of policy, the Board has adopted 3 incentive rate-making methods. Each of these 3 methods are described in the RRFE Report. They consist of the 4th Generation IR Model, the Custom IR Model, and the Annual IR Index Model. OEB policy does not permit each and every distributor it regulates to develop whatever multi-year incentive rate-making framework it considers to be appropriate. If that was the Board's intent, then it would have expressed it in its RRFE Report. Allowing each and every distributor to develop whatever multi-year incentive rate-making framework it wishes the Board to consider would be tantamount to having no incentive rate-making policy.

15. In its RRFE Report, the Board was quite specific in limiting distributors to 3 alternative rate-setting methods, the essentials components of which are detailed in the RRFE Report. Moreover, the Board was specific in expressing its expectation that the 4th Generation IR method would be appropriate for most distributors.

16. The Custom IR method is therefore an exception to the 4th Generation IR method. A distributor which seeks to have its rates set under the auspices of a Custom IR method must demonstrate that it meets the qualifying requirements and, if it does, must establish that its proposed rate-setting framework is compatible with the essentials of Custom IR rate-setting described in the RRFE Report.

17. Under the Board's incentive rate-making policy, a distributor who is unable to demonstrate that it qualifies for Custom IR, or even if it qualifies, is unable to demonstrate that its rate-making proposal is compatible with the essentials of the Custom IR model, as described in the RRFE Report, is, as a consequence, subject to having its incentive rates determined on the basis of incentive rate-making which is compatible with the Board's 4th Generation IRM rate-making model. Put another way, the Board cannot approve what EGD has proposed without completely undermining the IR rate-setting policy in the RRFE Report.

18. We submit that having regard to a correct interpretation of the Board's IR rate-setting policy, the onus is on EGD to convincingly demonstrate that, compared to regulated entities such as Union and others, its capital spending circumstances are so materially different that a Custom IR approach is warranted. Moreover, before it can qualify for Custom IR, the onus is on EGD to convincingly demonstrate that it can satisfy the fixed 5

year capital spending envelope requirements which apply to the Board's Custom IR rate-setting model and that it is prepared to operate under the auspices of such constraints.

19. EGD has not and cannot discharge this onus on either score. It has failed to establish that the capital cost pressures which it faces are so materially different from those faced by others, such as Union, that a Custom IR rate-making approach to its circumstances is warranted. Moreover, it cannot satisfy the fixed 5 year capital requirements envelope which applies to the Board's Custom IR rate-setting model. EGD is clearly not committed to operating under the auspices of such constraints.

20. In pith and substance, EGD's multi-year rate-making proposal is a 5 year COS proposal which does not qualify as a Custom IR Mechanism under the auspices of current Board IRM policy. EGD's proposed Customized IR Plan does not advance the evolution of IR in Ontario. Rather, it constitutes a giant step backwards to what is substantively a multi-year cost of service rate-setting method, which the Board has already stated is an inherently unreliable rate-setting method for periods greater in length than 2 years.[2]

21. EGD asks the Board to determine its rates for the 5 year period January 1, 2014 to December 31, 2018 under the auspices of an incentive rate-making method. EGD's so-called Customized IR proposal does not fall within the ambit of the Custom IR rate-setting method. The only IR rate-setting method within the ambit of the Board's policy which applies to EGD is the 4th Generation IR method. As a consequence, the Board should respond to the relief EGD requests by establishing an Incentive Rate-making framework for determining EGD's rates for the period 2014 to 2018 under the auspices of the only incentive rate-setting method which complies with Board policy, namely, the 4th Generation IR rate-setting method which, according to the RRFE Report, is to be applied to most distributors. The *OEB Act* fully empowers the Board to act in this fashion.[3]

22. The Board should refrain from being led down the multi-year Cost of Service rate-making alternative garden path by EGD. It is a course fraught with risks for ratepayers. Instead, the Board should provide EGD with what it asks for, namely, a 5 year incentive rate-making framework but one which falls within the ambit of and complies with the Board's Incentive Rate-setting policy.

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2 *Natural Gas Regulation in Ontario: A Renewed Policy Framework*, Report of the Ontario Energy Board, Natural Gas Forum, March 30, 2005.

3 *Ontario Energy Board Act*, s.36(3) and (5).

23. EGD's contention, at page 20 of its Argument-in-Chief, to the effect that there is no evidence to support findings pertaining to each of the elements of such a model for EGD is without merit. There is more than ample evidence in the record to support such findings.

24. The submissions which follow articulate the concepts and guiding principles which CME urges the Board to apply when responding to the long list of approvals EGD requests in connection with its proposed multi-year rate-making framework covering the period 2014 to 2018. In formulating and finalizing these submissions, we have greatly benefited from the detailed submissions provided by Board Staff on April 15, 2014, and from drafts provided to us of equally detailed submissions prepared by counsel and representatives for other intervenors, including, SEC, Energy Probe, Federation of Rental-housing Providers of Ontario ("FRPO"), Association of Power Producers of Ontario ("APPrO"), Consumers Council of Canada ("CCC"), and Vulnerable Energy Consumers Coalition ("VECC"). We support many of the points in those arguments, some of which rely upon evidence elicited during the course of the hearing by counsel for CME. In these submissions, we have attempted to supplement rather than duplicate the arguments so capably presented by others. Accordingly, we urge the Board to read the Arguments of others before turning its attention to the points presented in these submissions.

II. SITE RESTORATION COSTS ("SRC")

A. <u>Facts and SRC Issues in this case</u>

25. The background facts pertaining to the SRC issues are detailed in the submissions of Board Staff and counsel for SEC. For the purposes of our submissions on these issues, the essential facts can be summarized as follows:

(a) For years, EGD has been recovering from ratepayers amounts to fund future costs for removal and site restoration relating to property, plant and equipment;

(b) The SRC amounts have been recovered under the auspices of a mechanism which increases depreciation rates applicable to the relevant assets;

(c) According to EGD's Consolidated Financial Statements as of December 31, 2013, the SRC amounts actually collected to that year-end exceeded the amounts actually spent over the years by the staggering amount of $905M;

(d) This unfunded liability in the amount of $905M is not a calculated liability, as in the case of pensions, but is the excess of monies collected on account of SRC over and above monies paid for such items of expense;

(e) The $905M of ratepayer provided funds is not segregated and held exclusively for SRC use. Rather, the entire amount is used to support EGD's investments in utility assets. Since the $905M amount is a component of accumulated depreciation, the amount operates to reduce the Rate Base upon which the company earns a return. Similar to accumulated deferred taxes, the amount is effectively a source of ratepayer provided zero cost capital which EGD uses to support its investments in utility assets. Put another way, the property, plant, equipment and other assets EGD holds at December 31, 2013, having a Net Book Value ("NBV") of about $4B, would have a value as of December 13, 2013, close to $5B if the ratepayer provided SRC funds were segregated and protected;[4]

(f) Using a Constant Dollar Net Salvage ("CDNS") method for determining the appropriate level of the SRC reserve as of December 31, 2010, of about $753M, EGD's advisors have calculated that the reserve amount exceeds its appropriate level by some $292.8M;

(g) The discount rate used in the calculation of the appropriate December 31, 2010 SRC reserve level was 2.38% compared to materially higher discount rates used by EGD's actuaries in calculating its pension liabilities;

(h) The use of a higher discount rate in developing the appropriate level for the reserve at any point in time produces a lower liability value and, as a consequence, increases the refund amount being the difference between the calculated value of that liability and the cumulative SRC amounts collected from ratepayers in excess of the cumulative amounts then paid. EGD's response to Undertaking J9.2 indicates that a discount rate of 4.95%, being the yield on

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[4] In this context, it is apparent that almost 20% of the company's investment in utility assets at December 31, 2013, is supported by ratepayer provided zero cost capital. Apart from ordering the refund of the excessive amount in the current SRC reserve and a reduction of SRC payments going forward, these circumstances should prompt the Board to generically examine this SRC issue in depth in a future proceeding. Questions with respect to the ambit of future SRC cost to be recovered from ratepayers, the appropriate and most cost effective way to recover the amounts and the best way to protect ratepayer interests in the unutilized reserves need to be reviewed and clarified.

EGD's bonds around the end of 2013, lowers the December 31, 2010 liability value so as to increase the refund amount from $292.8M to $567.9M;

(i) Based on the appropriate liability value calculation as of December 31, 2010, provided by its advisors, EGD proposes to refund to ratepayers, over the 5 years 2014 to 2018, the $292.8M amount through a combination of rate-rider payments to ratepayers in the cumulative amount of $259.8M and a SRC refund-related adjustment to depreciation amounts recovered from ratepayers in the period 2014 to 2018 of $6.6M per year, for a cumulative total of $33M;

(j) On a go-forward basis, the excess amount in the current reserve, along with anticipated SRC expenditures in the years 2014 to 2018 at levels materially lower than those experienced historically, prompt EGD to propose a reduction in the amount being recovered for future SRC in rates over the period 2014 to 2018 from about $77M per year on average between 2009 and 2013 to about $49M per year for 2014 to 2018, even though the forecasted SRC expenses over those 5 years is only about $15M per year on average;

(k) EGD's witnesses accept that US GAAP accounting rules, with which EGD is now obliged to comply, do not permit the recording of a reserve for SRC costs. The amounts EGD can charge as SRC expenses are the costs it actually incurs for SRC in each year; and

(l) During the course of their testimony, EGD witnesses acknowledged that EGD has no legal obligation to pay SRC and that it is very difficult to predict whether all of the amounts being collected will be used or when any such amounts will be used.[5]

26. Having regard to these essential facts, and apart from our recommendation that the Board should initiate a generic process to review all matters related to SRC, the SRC issues for determination by the Board in this case are:

(a) The appropriate amount to be refunded to ratepayers over the period 2014 to 2018; and

5 In the absence of any legal obligation to pay SRC, the Board should consider the hypothetical scenario of EGD's entire system suddenly becoming obsolete. In such circumstances, would EGD, nevertheless, have to remove its entire distribution system from the ground? If so, and having regard to the fact that the entire amount of the SRC reserve has been used to support EGD's investments in utility assets, would EGD's owner pay the full amount of the SRC reserve to cover SRC costs? We think it unlikely that such an outcome would occur.

(b) The appropriate going forward SRC amounts to be collected in the January 1, 2014 to December 31, 2018 rates.

B. Refund Amount

27. There is a dispute between EGD and others pertaining to the amount to be refunded. EGD's position is that the amount to be refunded is $292.8M. This amount is based on the calculations of the appropriate liability at December 31, 2010, under the auspices of the CDNS method using a discount rate of 2.38%. The position of counsel for SEC is that, because EGD is now subject to US GAAP, the full amount of the SRC reserve should be refunded to ratepayers over 10 years. Board Staff submits that there should be no SRC refund.

28. At this time, we have no basis for questioning the appropriateness of the CDNS method upon which EGD's advisors rely. However, the discount rate of 2.38% is incompatible with discount rates used by EGD's actuaries to evaluate pension liabilities. Like others, we urge the Board to use a higher discount rate when determining the appropriate refund amount to be paid to EGD's ratepayers over the period 2014 to 2018.

29. As already indicated, the company's response to Undertaking J9.2 shows that using a discount rate of 4.95% rather than the 2.38% increases the refund amount from $292.8M to $567.9M. Having regard to this evidence, we submit that the Board should find that the amount to be refunded is materially higher than the amount proposed by EGD because the discount factor its advisors have used in their calculation of the refund amount is too low. For reasons which follow, we suggest that the refund amount over the period 2014 to 2018 should be at least $500M.

30. In its argument, Board Staff appears to support the proposition that a discount rate higher than 2.38% should be used to calculate the appropriate level for the liability, being a submission which increases the refund amount from $292.8M to $567.9M as shown in Exhibit J9.2. However, despite its support for a higher discount rate, Board Staff, curiously, does not support the refund of any portion of the SRC reserve of about $905M at December 31, 2013, apparently on the basis that EGD's management, lawyers and auditors have signed off on this number.

31. Board Staff submission at page 62 states:

> *Board Staff submits that had a higher discount rate been used at the outset the revised calculations would not produce a theoretical over-collection in the net present value calculations now.*

This statement is incorrect if it is intended to contradict the evidence contained in Exhibit J9.2. The use of a higher discount rate will invariably reduce the present value of a calculated liability at any point in time. On the other hand, if the statement is intended to mean that EGD's auditors independently considered and approved the discount rate used in the calculation of amounts which EGD recovers in negative salvage, then it is also an incorrect statement.

32. It is the Board and not the company's auditors which establishes the approved regulatory percentage increase in depreciation rates pertaining to negative salvage. In the company's audited Financial Statements, the auditors merely certify the extent to which amounts collected under the auspices of these Board approved negative salvage rates exceed the amounts spent on SRC. What the auditors sign off on is the statement reflected in note 10 of EGD's Financial Statements to the effect that the balance in the SRC reserve represents the amount that EGD has collected from customers net of actual costs expended on removal and site restoration.

33. Board Staff's argument that there should be no refund amount because the auditors have "signed off" on the extent to which amounts collected exceed actual costs expended is incorrect, without merit and circular. If such an argument were to prevail, then the Board could never find that the SRC reserve was too high. The auditor will not question the SRC amounts collected because they have been recovered from ratepayers under the auspices of Board approved negative salvage allowances. If, as Board Staff argues, the auditor's approval precludes the Board from finding that the amount recovered under the auspices of its approved negative salvage rates is currently too high, then the Board can never find that the amounts collected are, at any point in time, too high. If the submissions of Board Staff are accepted, then all the Board can do is change the negative salvage rates on a go forward basis. The Board's powers to order a refund are not constrained in any way by the auditors' actions. Board Staff's submissions to this effect are without merit and should be rejected.

34. Similarly, the musings contained in Board Staff's submissions to the effect that some $3B of SRC will be required to provide coverage for asset values ranging between $6B and

$10B are not evidence which supports a conclusion that the $905M being held at December 31, 2013, is appropriate. Leaving aside the absence of any legal obligation on EGD or its owner to pay SRC, the reality is that, to a significant extent, EGD's overall system has already been converted to a plastic system. This means that a large portion of the system is unlikely to become obsolete for 60 years or a considerably longer period, assuming adequate gas supply continues to be available. In these circumstances, we submit that the notion that a $3B reserve for SRC is required in the short to medium term is speculative in the extreme.

35. As already noted, we do not understand how Board Staff's submission at page 62, to the effect that had a higher discount rate been used in the derivation of negative salvage which EGD began to collect from ratepayers some 55 years ago, has any relevance to the refund issue. The hypothetical collection of lower amounts of negative salvage from 1959 onwards, based on the hypothetical use of a higher discount rate in determining the amounts recoverable, has no bearing on the quantification of the amounts by which the monies actually collected to date are excessive. The fact of the matter is that the $905M amount currently in the SRC reserve materially exceeds an appropriate calculation of the current value of the liability for future SRC costs.

36. For all of these reasons, we submit that there is no evidence to justify a finding that no refund in the current SRC reserve is warranted as Board Staff contends in its argument.

37. The position of counsel for SEC, that the full amount of the current SRC reserve should be refunded to ratepayers over 10 years, is based on the proposition that the Board should require EGD to adhere to the US GAAP accounting rules to which it is subject unless there is a valid regulatory reason to depart from those rules. EGD has provided no evidence to justify a departure from those rules.

38. Moreover, it is worthy of note that when a discount rate higher than 2.38% is used, the end-state which applies to the approach EGD proposes can lead to a repayment of a refund over 5 years in excess of $500M. This is essentially the same end-state, at December 31, 2018, under the approach SEC proposes. In these circumstances, and subject to a generic review process in a future proceeding with respect to SRC which we suggest below, we submit that the refund amount repayable to ratepayers over 5 years should be in the order of $500M and not the lesser amount EGD proposes.

C. Reduction in SRC Recovery on a Go-Forward Basis

39. With respect to the amount to be recovered for SRC over the years 2014 to 2018, we agree with SEC and Board Staff that the amounts should be limited to a cumulative amount of about $76M subject to the outcome of the generic review process described below pertaining to all aspects of SRC, including the need to protect ratepayer interests in these funds.

D. Generic Review of All Matters Related to SRC

40. Having regard to EGD's adoption of US GAAP and the extent to which the SRC reserve is currently being used by EGD as zero cost capital to fund utility investments, we submit that it is timely for the Board to conduct a generic review of all matters pertaining to the definition, calculation, and recovery of future SRC costs from ratepayers, including matters pertaining to the protection of ratepayer interests in the funds collected but not used for SRC purposes.

41. The National Energy Board ("NEB") is in the midst of conducting a generic review of the type we envisage. The NEB's review pertains to financial issues related to pipeline abandonment costs. The framework for the review being conducted by the NEB is found in its May 2009 Reasons for Decision in RH-2-2008[6]. That framework was informed by, amongst other things, a Background Paper on Negative Salvage[7] prepared by NEB Staff in September 1985.

42. We notified counsel for SEC of these NEB proceedings and our plan to propose, in this case, that the Board establish a generic proceeding of this nature to review all aspects pertaining to SRC. We are aware that counsel for SEC has responded positively to our conceptual suggestion that the Board initiate a generic review of SRC in parallel with SEC's proposal to refund, over 10 years, the $905M balance in the SRC reserve at December 31, 2013.

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6 https://docs.neb-one.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/501473/501196/564389/557894/A1J9R9_-_Reasons_for_Decision_RH-2-2008%2C_Land_Matter_Consultation_Initiative_Stream_3_.pdf?nodeid=557895&vernum=-2

7 https://docs.neb-one.gc.ca/ll-eng/llisapi.dll/fetch/2000/90463/501473/501196/501199/504177/542924/C-1-13C_Appendix_A_NEB_Negative_Salvage_Value_Report_1985_%28A1I2C5%29.pdf?nodeid=542931&vernum=-2

43. In his submissions, counsel for SEC provides considerable detail on the differences between financial issues pertaining to pipeline abandonment, being considered by the NEB, and a consideration, by this Board, of all matters pertaining to SRC or net negative salvage. We adopt in their entirety the submissions made by counsel for SEC pertaining to the type of generic review process which the Board should initiate. In addition to the 8 topics which the Board could address in such a generic proceeding described by counsel for SEC in his submissions, we wish to emphasize that the matters to be considered in such a review should include the appropriateness of continuing to recover SRC costs by way of an increment to depreciation rates to the extent that the Board authorizes EGD to depart from US GAAP accounting rules and to collect some future SRC costs in rates.

44. In a continued recovery of some SRC scenario, we strongly believe that the Board should subscribe to the guiding principles reflected in the NEB's framework to the effect that the collection of such funds should be transparent and separated from depreciation. Similarly, any such amounts should be collected as a separate line item of expense so that they avoid the additional ratepayer burden of the gross-up for income taxes which occurs when the amount is collected under the auspices of an increased depreciation rate. Moreover, the method used to calculate and collect any SRC in rates should clearly define the scope of SRC activities covered and should contain specific rules to avoid over-accumulation or under-accumulation in the SRC reserve. The generic review initiative which we recommend should also be structured to consider the segregated fund issue raised by Board Staff in its submissions, along with any other appropriate measures to protect ratepayer interests in unutilized SRC.

E. <u>SRC Refund and Pay-as-you-go Implementation and Impacts</u>

45. Conceptually, we see little, if any, difference between the draw-down of accumulated SRC and the draw-down of accumulated deferred taxes. In the late 1990s, the Board directed Union to commence collecting income taxes on a pay-as-you-go basis and to refrain from collecting deferred taxes. Union was directed to refund the accumulated deferred tax balance in a manner which took into consideration all matters relevant to the public interest. The approved method for refunding the accumulated deferred tax balance included refunds in varying annual amounts paid over a fixed period of amortization. We submit that these same guiding principles should be applied when determining the

appropriate approach for EGD's payment, over the years 2014 to 2018, of the refund amount found by the Board to be appropriate.

46. As already noted, we support the payment of a cumulative refund amount in those 5 years in the order of $500M with the draw-down amounts in each year to be structured to have reductions in rate and bill impacts in the early years greater than in the later years, so that an upward spike in rates between 2018 and 2019 is either avoided or substantially mitigated.

47. In this context, the detailed submissions made by counsel for SEC pertaining to the method of refunding the excess reserve amount under the auspices of a rate-rider which draws down and refunds, over 5 years, about $500M of the $905M reserve fund at December 31, 2013, are entirely compatible with these guiding principles. We agree with counsel for SEC that the proposed draw down of accumulated SRC and the payment of the appropriate refund amounts to ratepayers in the 2014 to 2018 time frame should include therein the "ripple" effect of that draw down in each of those years. The "ripple" effect of SRC draw-downs consists of grossed-up tax savings and grossed-up cost of capital effects associated with the Rate Base increases in each year caused by the draw down in each year. We submit that the approach SEC proposes for implementing the refund feature of the SRC issue is transparent and sensible and urge the Board to adopt it.

48. Similarly, we support SEC's proposal to implement the "pay-as-you-go" method for recovering SRC in rates during the period 2014 to 2018 by way of an adjustment to 2013 revenue requirements and rates which backs out the SRC recovery reflected therein and then adds the net effect of:

(a) The 2013 SRC expense under the pay-as-you-go approach;

(b) The increase in return on Rate Base prompted by reducing 2013 depreciation expense; and

(c) The decrease in grossed-up income tax due to the increase in Rate Base attributable to the reduction in 2013 depreciation expense.

49. We rely on the submissions of counsel for SEC pertaining to the rate and bill impacts associated with his recommendations.

F. <u>Summary</u>

50. By way of summary, we submit and urge the Board to find as follows:

(a) The SRC reserve at December 31, 2013, of about $905M is excessive;

(b) The sum of about $500M in the SRC reserve at December 31, 2013, should be refunded to ratepayers over the period January 1, 2014 to December 31, 2018, in the manner proposed by counsel for SEC;

(c) The amount which EGD should be permitted to recover in rates for SRC for the period January 1, 2014 to December 31, 2018 should be limited to the amount permitted under US GAAP accounting rules;

(d) Beyond December 31, 2018, the recovery of SRC in rates should depend on the outcome of a generic review to be initiated by the Board to address all matters relevant to the recovery of SRC from the utilities which it regulates.

III. INCOMPATIBILITY OF EGD'S PROPOSAL WITH BOARD'S INCENTIVE RATE-MAKING POLICY

A. Incentive Rate-Making and its Essential Components

51. Incentive rate-making operates from a base of a Board approved revenue requirement and resulting rates for an historic or bridge test year adjusted, as necessary, to reflect an appropriate launching pad for an incentive rate-making adjustment mechanism determined by the Board to be appropriate. Incentive rate-making calls for an annual adjustment mechanism derived from and linked to factors external to the year-over-year changes in a particular utility's forecasts of revenues and costs. In this way, the annual adjustment mechanism is decoupled from costs.

52. Benefits for ratepayers are to be built into the annual adjustment mechanism by means of appropriate productivity and stretch factors. To qualify as an incentive rate-making annual adjustment mechanism, something other than changes in year-over-year forecasts of utility specific revenues and costs is required. Changing rates annually to reflect changes in utility specific forecasts of revenues and costs is not a "mechanism". Rather, it is a process which falls within the ambit of Cost of Service rate-making and outside the ambit of incentive rate-making.

53. Incentive rate-making is a method where, in consideration of embedding benefits for ratepayers in an annual adjustment mechanism and taking risks incremental to the risks

covered by the Board's allowed Return on Equity ("ROE"), a utility is afforded the opportunity to realize rewards incremental to the allowed equity return.

B. The Board's Incentive Rate-Making Policy

54. We reiterate that as a matter of policy, the Board has adopted 3 incentive rate-making methods and that, in its RRFE Report, the Board was quite specific in limiting distributors to these 3 rate-setting alternatives which are the 4^{th} Generation IR Model, the Custom IR Model, and the Annual IR Index Model.

55. The Custom IR method is an exception to the 4^{th} Generation IR method which the Board expects to be appropriate for most distributors. If a distributor is unable to demonstrate that it has capital expenditures of the type which fall within the ambit of Custom IR or is unable to demonstrate that its rate-making proposal is compatible with the essentials of the Custom IR model, then the incentive rate-setting method which applies to that distributor is one which is compatible with the Board's 4^{th} Generation IR rate-setting method.

C. Incompatibility of EGD's Proposal with Custom IR

56. A utility wishing to establish rates under the auspices of the Custom IR method needs to convincingly establish the following:

    (a) Planning and budgeting processes which are compatible with the approaches that would be followed by competitive, cost minimizing and profit maximizing companies:

    - Competitive cost minimizing and profit maximizing companies plan their expenditures in a manner which will enable them to keep pace with their peers. Prioritizing and pacing expenditures is part of the planning and budgeting processes followed by such companies. Significantly influencing the budgets of such companies are external circumstances pertaining to what their competitors are doing. In many cases, zero based budgeting is the starting point in the planning and budgeting processes followed by such companies.
    - We agree with Board Staff that a long range asset management plan from which budgets are derived in a manner which is compatible with those plans is the type of budgeting and planning process which would be followed by competitive, cost minimizing, and profit maximizing entities.

- The planning and budgeting processes followed by EGD, as presented in this case, are not compatible with the processes followed by competitive, cost minimizing and profit maximizing companies. EGD's budgeting starting point calls for plans covering all expenditures which can arguably be justified as necessary. In its entirely, EGD's process is internally focused. Budgets from such a process followed by a series of internally managed "scrubs", to eliminate variable or uncertain amounts and to produce lower budgeted amounts by embedding so-called productivity commitments, do not produce an outcome which is compatible with the planning and budgeting processes of competitive, cost minimizing and profit maximizing companies.

(b) A 5 year capital plan involving capital expenditures which are significantly large or highly variable compared to historical levels but which are, nevertheless, sufficiently definitive to enable the applicant utility to commit to manage within the rates based on such a plan, bearing in mind that actual costs and revenues will vary over the period of the 5 year plan:

- The 5 year capital plan that emerges from a budgeting process envisaged by incentive regulation is not open ended and subject to a plethora of risk minimizing deferral accounts of the type EGD currently enjoys and the additional deferral accounts which it proposes.
- Electricity utilities operating under the auspices of the Custom IR model must do so without a broad array of risk minimizing deferral account protection of the type contained in EGD's proposal.

(c) An "annual adjustment mechanism" which represents a fundamental shift from the COS process used to change rates from year to year:

- Making changes to annual rates to reflect differences in the forecasts of yearly expenses and revenues is not a "mechanism" for adjusting rates which falls within the ambit of incentive regulation. Rather, it is a process for producing rate changes which is an essential ingredient of COS rate-making. An essential of incentive rate-making is an annual adjustment mechanism other than the outcome of year-over-year prospective test year revenue requirement forecasts.

(d) An "annual adjustment mechanism" having built into it expected inflation and productivity gains having regard to empirical information derived from the distributor's forecast (revenues and costs including inflation and productivity), the Board's inflation and productivity and analyses; and, benchmarking to assess the reasonableness of distributor forecasts, which information is to be used to develop a distributor specific rate trend for the plan term which can be smoothed if necessary:

- Most, if not all, of these essential features of the annual adjustment mechanism, which is a requirement of Custom IR, are absent in EGD's proposal. In particular:
  - EGD's internal forecasts of Capital, OM&A and other costs and expenses are deficient because they lack external support;
  - The proposal does not contain a rate adjustment mechanism which is compatible with Custom IR requirements;
  - Year-over-year changes in its forecasts of revenues and costs, is the COS process for changing rates and lies outside the ambit of incentive rate-making;
  - There is no rate adjustment mechanism which has a built-in externally influenced productivity factor. Adequate benchmarking information from sources external to the utility, such as that being used by the Board to set rates for other utilities it regulates, has not been used by EGD to develop an annual rate adjustment mechanism. Unreasonably high utility specific cost forecasts which have supposedly been made lower than they would otherwise be because of productivity commitments supposedly built into the forecasts fall outside the ambit of an incentive rate-making annual adjustment mechanism;
  - There is no annual rate adjustment mechanism which reflects any distributor-specific rate trend for the term of the Plan.

57. EGD has not demonstrated that its circumstances fit the qualifying requirements of Custom IR, and even if it did qualify, the multi-year rate-making framework it proposes is wholly incompatible with Custom IR requirements.

IV. THE APPROPRIATE REMEDY – INCENTIVE RATE-SETTING FOR EGD WHICH COMPLIES WITH BOARD POLICY

58. We submit that the Board should respond to EGD's request to have its rates set for 5 years under the auspices of an incentive rate-making method by applying to EGD the incentive rate-making method, is within the ambit of the Board's incentive rate-making policy which applies in EGD's circumstances. For the reasons already outlined, that rate-setting framework is one which falls within the ambit of the 4th Generation IR rate-setting method described in the RRFE Report and includes a modular approach to any large capital expenditure projects within the ambit of EGD's spending plans. EGD's application contains no request for rate-making relief under the auspices of a Cost of Service rate-making framework. We strongly urge the Board to refrain from becoming engaged in such a rate-making framework by proceeding to evaluate, on a line by line

and envelope basis, whether the myriad of forecasts which EGD has presented for each of the years 2014 to 2018 to support its request for rate relief are reasonable or unreasonable.

59. That multi-year rate-making under the auspices of a Cost of Service rate-making framework based on year-over-year changes in forecasts made for a period of 5 years is fraught with risks for ratepayers is evident from the submissions made by Board Staff and other intervenors. Others have detailed in their submissions the extent to which EGD's forecasts are unreliable and lack credibility for the purpose of setting rates for a period of 5 years. The fact that EGD management represented to its Directors that it could achieve on an annual basis some 60 basis points of equity return over and above the Board approved ROE is evidence which, in and of itself, discredits EGD's argument that its forecasts have been set at levels which are as low as prudently possible.

60. The over-earnings potential associated with 5 years of forecasts of costs and expenses which are not trued-up on an annual basis is enormous. A capital expenditure under-spend of $90M per year leads to cumulative over-earnings of some $100M per year. EGD contends that a capital under-spend of $90M per year is unrealistic, yet, as demonstrated by counsel for SEC in his submissions, in 2006, the Board disallowed $150M of EGD's $450M capital budget presented in response to the same types of cost pressures which it repetitively referenced in this case. We submit that the $150M disallowance demonstrates that a $90M per year capital under-spend is not an unrealistic scenario. Moreover, despite the $150M capital expenditure disallowance for that year, EGD, nevertheless, managed to over-earn on a normalized basis as it has done for the past several years.

61. That said, we reiterate that our strong recommendation is that the Board proceed, in this case, by continuing to recognize that multi-year rate-setting under the auspices of a Cost of Service format is fraught with risks for ratepayers. Instead, the Board should focus on the evidence in this case which is relevant to establishing the elements of a 5 year incentive rate-making framework for EGD which falls within the ambit of the Board's Incentive Rate-making policy. An incentive rate-making framework is what EGD requested and an incentive rate-making framework which falls within the ambit of the Board's Incentive Rate-making policy should be the outcome of this proceeding.

V. APPROPRIATE IR RATE-MAKING FRAMEWORK FOR EGD

62. The Incentive Rate-setting Model which the Board has approved for Union falls within the ambit of the 4th Generation IR rate-setting method described in the RRFE Report. The Union Incentive Rate-setting Model should be used by the Board as a guide for establishing the incentive rate-making framework for EGD which is compatible with Board policy. Our submissions on the components of the EGD framework which the Board should establish parallel those made by counsel for SEC and others and are set out below.

A. Base Year Revenue Requirement and Rates

63. EGD's revenue requirement and rates were re-based on a Cost of Service basis for the 2013 test year. Subject to such adjustments that the Board considers to be appropriate, this 2013 revenue requirement and its resulting rates should form the base from which an IRM framework for EGD covering the period January 1, 2014 to December 31, 2018 should operate.

64. The 2013 base year revenue requirement should be adjusted by $31.2M to reflect EGD's actual 2013 normalized revenues in excess of the Board return. An incentive rate-making mechanism should operate from a base year revenue requirement which limits the recovery in rates to the Board approved return. Over the 5 years, this adjustment would reduce the amounts recovered from ratepayers by about $156M. This base year adjustment is similar in its effect to the revenue requirement reduction and stretch factor advocated by Board Staff totalling about $128.6M over 5 years. In the context of incentive rate-making, which is compatible with Board policy, we submit that the base year adjustment approach is the appropriate approach to follow rather than the revenue requirement adjustment approach proposed by Board Staff.

65. Over and above the 2013 over-earnings adjustment, there should be a base rate adjustment for SRC as counsel for SEC proposes.

66. Without prejudice to the rights of parties on the next rebasing, the RCAM amount embedded in base rates should remain unchanged.

67. A regulatory cost adjustment could be made to base rates in the event that the amount embedded in 2013 rates is more than the amount of $6M referred to by Board Staff in their submissions.

68. In accordance with the Board's established incentive rate-making policy, base year capital structure and costs of capital, including ROE, should remain fixed during the 5 year term of the IR Plan. Fixing capital structure and costs of capital at the base year levels for the term of the IR Plan are one of the added risks assumed by the utility which justifies the potential for rewards over and above the ROE embedded in base rates.

B. Annual Adjustment Mechanism

(i) Inflation

69. We submit that the evidence pertaining to an appropriate inflation factor for EGD to which the Board should ascribe the greatest weight should include the following:

- The Board's determination a few years ago that inflation measured by GDI IPI is an appropriate measure of inflation for gas distributors;
- The acceptance by EGD and Union of inflation measured by GDI IPI for gas distributor rate-setting for the period 2008 to 2012 and the Board's approval thereof;
- Union's acceptance of GDI IPI as the appropriate measure of inflation for gas distributor rate-setting for the period 2014 to 2018 and the Board's approval thereof;
- The Board's observations in the RRFE Report that a more industry specific inflation factor should be developed for electricity distributors;
- The Board's adoption of an inflation factor for electricity distributors for 2014 which we understand from the submissions of counsel for SEC was at a rate of 1.7%;
- The evidence of Mr. Coyne and Dr. Kauffman pertaining to inflation.

70. Based on a consideration of this evidence, we urge the Board to find that inflation measured by GDI IPI remains appropriate for EGD and to determine for 2013 that the inflation factor to be used in the annual adjustment mechanism for EGD is 1.7%.

(ii) Productivity Factor including Stretch

71. We submit that the evidence which should guide the Board's determination of this issue should include the following:

- EGD's acceptance of and the Board's approval of a productivity factor including stretch expressed as a proportion of inflation for distributor incentive rate-making for the period 2008 to 2012 at an average of 50% of inflation coupled with EGD's over-earnings in each of the years 2008 to 2012 averaging about $29M per year;

- Union's acceptance of and the Board's approval of a productivity factor including stretch built into the annual adjustment mechanism in the amount of 60% of inflation for gas distributor rate-making for the period 2014 to 2018;
- The evidence of Dr. Kauffman pertaining to productivity levels in general for North American gas distributors in the order of 1%.

72. Based on a consideration of this evidence, we urge the Board to find a productivity factor including stretch for EGD at 60% of inflation, being the same productivity factor including stretch which is applicable to Union in 2014.

C. Y Factors

73. Gas Costs, including Upstream Gas Transportation and Unaccounted for Gas Volume Variances, should continue to be treated as Y factors, along with Demand Side Management ("DSM") costs, Customer Information System ("CIS") and Customer Care costs. The treatment of Pensions and the Other Post-Employment Benefits ("OPEB") as flow-through items of cost should continue.

74. Major capital projects such as the Greater Toronto Area ("GTA") and Ottawa reinforcements should be treated as Y factors under the auspices of the same terms and conditions for such factors approved by the Board for Union.

75. We agree with counsel for SEC that benefits associated with the Work and Asset Management System ("WAMS") project need to be taken into account when determining whether WAMS qualifies for major capital project coverage under the auspices of the major capital projects Y Factor terms and conditions derived from Union's Board approved IRM Plan.

D. Deferral and Variance Accounts

76. We adopt the submissions of Energy Probe with respect to deferral and variance accounts. In particular, we agree that, except for the Ontario Hearing Costs Variance Account, existing deferral accounts should continue and that there should be no change to the parameters of the Transactional Services Deferral Account ("TSDA"). The new deferral accounts requested by EGD should be limited to those described by Energy Probe in its submissions.

E. Z Factors

77. The Z factor language should not be broadened to the extent EGD proposes. Rather, the language should be clarified as described in the submissions of Board Staff.

F. Term of the Plan

78. The term of the Plan should be for 5 years from January 1, 2014 to December 31, 2018.

G. Off-Ramps

79. Above the ROE of 8.93% embedded in 2013 base rates, there is no need for an off-ramp if Earnings Sharing beyond 200 basis points is 90/10 in favour of ratepayers. We have no objection to an Earnings Sharing Off-Ramp at 300 basis points below the 8.93% ROE embedded in base rates.

H. Earnings Sharing Mechanism ("ESM")

80. The Earnings Sharing Mechanism should be asymmetric and apply to earnings in excess of the 8.93% ROE embedded in base rates. There should be a 100 basis points dead-band, 50/50 sharing between 100 and 200 basis points, and 90/10 sharing beyond 200 basis points.

I. Reporting Requirements

81. The information to be filed by EGD with the Board and intervenors should be the same as that as described in the Union Incentive IR Plan and include an annual stakeholder meeting as described therein.

J. Rate-Setting Process

82. We agree with counsel for SEC that the EGD plan should be structured as a Revenue per Customer Cap plan with the result that the annual adjustment process should essentially be the same as it was under the auspices of EGD's Revenue per Customer Cap plan covering the period 2008 to 2012.

83. The rates for 2014 should be established in accordance with this rate setting process with customer additions and revenues for 2014 to be adjusted in accordance with the submissions made by Energy Probe with respect to those items.

K. Rebasing

84. The rebasing provisions of EGD's Incentive Rate-making framework should parallel the rebasing provisions of Union's Board approved plan.

VI. SUSTAINABLE EFFICIENCY INCENTIVE MECHANISM ("SEIM")

85. We support the criticisms made by others of the inappropriateness of EGD's proposed SEIM and urge the Board to reject the proposal. In addition to the criticisms made by others, we submit that a SEIM feature for incentive rate-setting under the auspices of the 3 methods available in accordance with Board policy is inappropriate because the intent of each of those rate-setting methods is to prompt distributors to achieve sustainable efficiencies. We can see no good reason to layer on to an existing incentive rate-setting method a further incentive to achieve that outcome. A more appropriate way of prompting the achievement of sustainable efficiencies during the operation of an incentive rate-making mechanism is to penalize a distributor which achieves efficiencies during the course of the IRM which are not sustainable.

86. Moreover, the SEIM issue is a generic issue which should be considered and determined in a generic proceeding. It is premature to deal with this issue in this case.

VII. COST ALLOCATION AND RATE DESIGN

87. We support the principle that costs should be allocated on the basis of cost causation. Beyond that, we make no submissions with respect to the cost allocation proposal made by APPrO.

88. The rate design changes proposed by EGD are acceptable.

VIII. IMPLEMENTATION

89. CME agrees that rates should have an effective date of January 1, 2014.

90. On the assumption that the Board establishes an incentive rate-making framework for EGD which is compatible with the 4th Generation IR method and determines that EGD is to pay a SRC refund to ratepayers as well as reduce its recovery of SRC in the years 2014 to 2018 to a level less than the SRC costs currently embedded in 2013 rates, we submit

that the implementation steps to be taken following the release of the Board's decision should include directions that:

(a) EGD to present, separately, the 2014 revenue requirement and rate impacts of the Board's Incentive Rate-making Framework determinations and its SRC determinations;

(b) The foregoing separately presented determinations then be merged to reflect their combined impact on 2014 revenue requirement and rates; and

(c) A Technical Conference be held following the release of the decision to enable interested parties to address any other matters pertaining to implementation.

IX. COSTS

91. CME requests that it be awarded 100% of its reasonably incurred costs in connection with this matter.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 22nd day of April, 2014.

Peter C.P. Thompson, Q.C.
Vincent J. DeRose
Kim Dullet
Counsel for CME

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