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May 7, 2014

VIA RESS, EMAIL and COURIER

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

In accordance with the Ontario Energy Board's letter dated May 2, 2014, enclosed please find the Reply Argument of Enbridge for the above noted proceeding.

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

Yours truly,

(Original Signed)

Bonnie Jean Adams
Regulatory Coordinator

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

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.

REPLY ARGUMENT
OF ENBRIDGE GAS DISTRIBUTION INC.

May 7, 2014

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EB-2012-0459

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REPLY ARGUMENT OF ENBRIDGE GAS DISTRIBUTION INC.

1. Introduction

On March 31, 2014, Enbridge Gas Distribution Inc. (Enbridge, or the Company) submitted its Argument in Chief in this proceeding. Enbridge received submissions in response to its Argument in Chief from Board Staff and from the following intervenors: Association of Power Producers of Ontario (APPrO), Building Owners and Managers Association Toronto (BOMA), Canadian Manufacturers & Exporters (CME), Consumers Council of Canada (CCC), Energy Probe Research Foundation (Energy Probe), Federation of Rental-Housing Providers of Ontario (FRPO), Industrial Gas Users' Association (IGUA), School Energy Coalition (SEC) and Vulnerable Energy Consumers Coalition (VECC).

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

The final arguments of Board Staff and intervenors total more than 450 pages in length. Enbridge will not attempt to respond to each and every argument or comment made in the submissions of others. But the lack of explicit reply by Enbridge to any argument or comment should not be taken as agreement with the particular point.

2. A Constructive Approach to Incentive Regulation

Working within the direction and guidance available to it from the Board and from other sources, Enbridge developed and brought forward a proposal that it envisioned to be a constructive approach to the evolution of Incentive Regulation (IR) in Ontario. In its Argument in Chief, Enbridge set out a number of the sources of guidance that it drew upon in developing its IR proposal.[1]

As explained both in the evidence and in Argument in Chief, Enbridge took account of all of these sources of guidance, including the Board's Natural Gas Forum (NGF) report[2] and the Renewed Regulatory Framework for Electricity (RRFE) Report,[3] it gave due consideration to its own particular circumstances and it considered the interests of its customers as it developed its 2014-2018 IR proposal.

The outcome of these efforts by Enbridge is the proposed Customized IR plan. While it was indeed very challenging for Enbridge to be the first applicant before the Board with an IR proposal involving a customized approach, Enbridge has been able to develop and bring forward a thoughtful and meaningful application for the Board's consideration.

Enbridge has endeavoured to maintain its constructive attitude towards the development of an appropriate IR methodology throughout the course of this proceeding. Enbridge's efforts to bring a constructive approach to this proceeding can

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[1] VECC asserts in its Final Argument (at pp. 8-9) that Enbridge's Argument in Chief makes no mention of whether the Customized IR plan fulfills Board objectives adopted from section 1 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sched. B. These objectives were addressed in Enbridge's evidence at Exhibit A2-1-1 and, rather than repeating this evidence in Argument in Chief, Enbridge made note of the evidence in footnote 3 on page 4 of its Argument in Chief.
[2] *Natural Gas Regulation in Ontario: A Renewed Policy Framework*, Report on the Ontario Energy Board Natural Gas Forum, March 30, 2005.
[3] *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach*, October 18, 2012. (the RRFE Report)

be seen, for example, from the course of events relating to the term of the proposed plan.

The report dated October 2013 by Pacific Economics Group Research, LLC (PEG) provided comments on the Customized IR plan as originally proposed by Enbridge in this proceeding. Under the heading The "Customized" Incentive Regulation Option, the PEG Report discussed the requirements for Custom IR as set out in the RRFE Report and asserted that Enbridge's proposal "does not meet those requirements".[4]

This discussion in the PEG Report gave one, and only one, reason for the conclusion that Enbridge's original proposal did not meet the requirements for Custom IR. The PEG report stated that Enbridge's (original) proposal fell short of the Board's "minimum term of five years" and that the proposal to "calibrate" rates for the years 2017 and 2018 required the adjudication of an application within the term of the proposed plan which, PEG said, was "clearly incompatible" with the Board's expectations and objectives for Custom IR.[5]

Subsequent to the filing of the PEG Report, Enbridge took action to address the one reason given for the conclusion that the proposed Customized IR plan did not meet the requirements for Custom IR. Specifically, Enbridge filed updated evidence to remove the proposal for an in-term review of capital spending needs for 2017 and 2018 and to establish clearly that the Customized IR plan is in accord with the Custom IR requirement of a minimum five year term. The updated evidence indicates that,

> In its original filing, the Company proposed a Customized IR plan with a five year term, including an update of capital spending requirements for 2017 and 2018 to address the difficulty in forecasting such costs at this time. Now, having considered concerns raised about the plan to revisit costs midway through the IR term, Enbridge has updated its Customized IR Plan to allow for all aspects of 2014 to 2018 Allowed Revenue to be set in this proceeding.[6]

[4] *Enbridge Gas Distribution's Customized Incentive Regulation Proposal: Assessment and Recommendations*, Pacific Economics Group Research, LLC, October 2013 (PEG Report), Ex. L-2, p. 13.
[5] PEG report, *supra*, p. 14.
[6] Ex. A2-2-2, p. 2, para. 7.

Enbridge believes that, through the course of the hearing of this application, it continued to explain and address the Customized IR plan in a constructive manner, consistent with the spirit in which the plan was developed. Enbridge assembled and presented witness panels comprising, in the aggregate, a considerable number of knowledgeable witnesses able to provide meaningful assistance on all aspects of the application. The witness panels endeavoured to provide, where appropriate, evidence in chief that explained key aspects of Enbridge's case, while not adding any significant amount of time to the overall length of the hearing. In the words of SEC: "The fact is that the Applicant presented a wide range of experienced and knowledgeable witnesses to speak to both the overall plan, and the specific elements of that plan."[7]

Over the course of 11 days of oral testimony, there were relatively few objections to questions, the witnesses were cooperative and helpful in their efforts to answer questions and, in Enbridge's view at least, the witnesses were able to convey successfully the theory and details of the Customized IR plan, as well as a sense of Enbridge's willingness to make reasonable and appropriate adjustments to the plan and to approach Customized IR with a constructive attitude.

Hence, it came as a disappointment to Enbridge that arguments from others seem, in many areas, to bear little relationship to the evidentiary portion of this proceeding. These arguments bring forward many ideas, opinions, comments, suppositions and assertions that do not have a proper grounding in the evidence. Perhaps parties realized that, following the evidentiary portion of the hearing, there was little on the hearing record that effectively diminished Enbridge's case. This, though, does not give parties licence to introduce ideas in final argument that are not supported by evidence, or assertions that have not been properly tested in the hearing process, or both.

Notwithstanding its concerns about these arguments, Enbridge continues to maintain a constructive attitude towards the development of an appropriate IR methodology, Enbridge accepts that some stakeholder proposals are appropriate for inclusion in the

[7] Final Argument of SEC, p. 9, para. 2.4.3.

Customized IR plan. Many of these are items that were raised for the first time within intervenor arguments. Having considered these proposals, Enbridge agrees that the following further adjustments can be made to the Customized IR proposal[8]:

(i) changes to Z Factor wording consistent with Board Staff's position;

(ii) changes to the ESM mechanism;

(iii) annual updates to the ROE and cost of debt that are to be included within Allowed Revenue amounts;

(iv) additional annual reporting, including detailed annual reporting of capital spending, and an evaluation of where the actual spending is different from what is included within Allowed Revenue amounts, and reporting of SQR results and reporting of RRRs related to the regulated utility;

(v) the addition of an annual stakeholder meeting to discuss past results and future plans;

(vi) additional reporting on gas supply items; and

(vii) changes to the proposed 2017/2018 variance accounts related to certain mains activities, to make the applicability threshold much higher.

In short, Enbridge has, from beginning to end of this case, made a sincere and constructive effort to deal with the challenges of being the first Customized or Custom IR applicant before this Board. Enbridge believes that its efforts result in a plan that delivers on the "value for money" proposition enunciated in the RRFE Report.

The RRFE Report explains the "value for money" concept in the following manner:

[8] These items are addressed in more detail within subsequent sections of this Reply Argument.

> The Board needs to regulate the industry in a way that serves present and future customers, and that better aligns the interests of customers and distributors while continuing to support the achievement of public policy objectives, and that places a greater focus on delivering value for money. …
>
> The renewed regulatory framework is a comprehensive performance-based approach to regulation that is based on the achievement of <u>outcomes that ensure that Ontario's electricity system provides value for money for customers.</u> The Board believes that emphasizing results rather than activities, will better respond to customer preferences, enhance distributor productivity and promote innovation.[9]
>
> (Emphasis added.)

The RRFE Report goes on to indicate that, in light of the value for money objective, the following outcomes are appropriate for distributors:

> *Customer Focus:* services are provided in a manner that responds to identified customer preferences;
>
> *Operational Effectiveness:* continuous improvement in productivity and cost performance is achieved; and utilities deliver on system reliability and quality objectives;
>
> *Public Policy Responsiveness:* utilities deliver on obligations mandated by government (e.g., in legislation and in regulatory requirements imposed further to Ministerial directives to the Board); and
>
> *Financial Performance*: financial viability is maintained; and savings from operational effectiveness are sustainable.[10]

As the discussion from the RRFE Report shows, value is not only about the cost of something, it is about the outcomes that result. These outcomes may come in the form of higher customer satisfaction, greater reliability, or importantly, improved safety. Enbridge agrees that cost is a vital part of the equation. At a very detailed level, Enbridge has addressed in evidence how it has responsibly, accountably, and

[9] RRFE Report, pp. 1 and 2.
[10] RRFE Report, p. 2.

transparently put forward its cost forecasts, its cost commitments and its cost risks. But cost is not the only part of the equation.

Enbridge's circumstances are summarized in the following paragraph from its pre-filed evidence in this case:

> Enbridge … continues to be one of the fastest growing utilities in North America. With a strong focus on customer satisfaction and safety, the Company continues to provide exceptional value to customers, businesses and communities within its franchise area. As the result of consistent growth over many years, combined with aging infrastructure and increasing distribution safety expectations, the Company is now faced with significant challenges. Substantial investments well in excess of historic levels need to be made in the distribution system in order to maintain safety, reliability, and growth.[11]

Enbridge's evidence also summarizes how "value for money" will be achieved in these circumstances, as follows:

> The certainty provided through Enbridge's proposed Customized IR plan will benefit all stakeholders and will assist the Company in meeting its own objectives (commitment to safety, assisting customers to get value for energy dollars and delivering shareholder value through the opportunity to earn Allowed ROE).[12]

More specifically, Enbridge has proposed a Performance Measurement Framework in this case that will enhance transparency and accountability.[13] The Framework is explained in a series of exhibits that describe how Enbridge will measure, monitor, track and report on outcomes.[14] As stated in the evidence, the Framework will provide both visibility into Enbridge's efforts to implement sustainable productivity initiatives and an effective mechanism to communicate performance and outcomes over the IR term. The Framework is comprised of two reporting mechanisms, a Productivity Initiatives Report and a Performance Metrics Benchmarking Report.

[11] Ex.A2-1-1, p. 1.
[12] Ex.A2-1-1, p. 39.
[13] 1Tr.67.
[14] Ex. A2-11-1, pp. 2 and 3.

The objectives of the Productivity Initiatives Report are: (i) establishment and maintenance of records of productivity and efficiency initiatives; (ii) simplicity; and (iii) visibility to linkages between initiatives and outcomes, *i.e.*, the reports will focus on showing the results of an initiative, whether the results are successful or not.[15] The Performance Metrics that will be used to measure the outcomes of Enbridge's activities and results have been organized into the following three categories: (i) Customer Relationship; (ii) Operational Performance; and (iii) Financial Performance.[16] Obviously, these categories line up closely and purposefully with the "value for money" outcomes described in the RRFE Report.

Thus, measurement of outcomes in these categories will allow stakeholders, the Board, and Enbridge's customers to evaluate "value for money" as it is conceptualized in the RRFE Report. Further, as set out in more detail later within this Reply Argument, Enbridge is willing to accept additional reporting and transparency, including an annual stakeholder session, additional annual information reporting, and ongoing gas supply reporting. Enbridge also expects to provide detailed annual reporting on its actual capital spending, in accordance with the Board's expectations under the RRFE Report.

All of this increased reporting is meant to increase the visibility of, and accountability for, performance outcomes. Enbridge's record for delivering performance outcomes will be available for any stakeholder, the Board and the public, to assess and evaluate Enbridge's performance. As contemplated in the RRFE Report,[17] Enbridge expects that the Board will closely monitor the capital programs during the IR term. Any of this information can be used by any stakeholder, the Board and the public, at the end of the IR term when Enbridge applies for rebasing.

Enbridge's evidence regarding the proposed Performance Measurement Framework was not explored in any significant way by any intervenor at any time throughout this proceeding. While intervenors focused on a high level view of costs, and not on details

[15] Ex. A2-11-2, p. 3, para. 9.
[16] Ex. A2-11-2, pp. 5-6, para. 16.
[17] RRFE Report, p. 20.

of the costs or what the costs will deliver, Enbridge's evidence speaks at length, and in great detail, about what is specifically driving costs. For example, the B-series of exhibits is laid out in a manner that describes each particular category of work that is required; why the work is required (inclusive of pictures illustrating the issues to be resolved); how the work will deliver on the outcomes referred to above; and the cost, pacing and prioritization of spending.

In all, there are many facets of Enbridge's evidence that speak to delivering on the "value for money" objective outlined by the Board in the RRFE Report. Intervenor arguments reveal little or no regard for the outcomes element of the "value for money" proposition.

3. IR Should be Aimed at Sustainable Efficiencies, Not Arbitrary Cost Cutting

As has been consistently noted throughout this case, the NGF Report set out three criteria for a multi-year IR plan, or "gas rate regulation framework". One of the three criteria is as follows:

> …establish incentives for sustainable efficiency improvements that benefit both customers and shareholders.[18]

In this context, the word "sustainable" has two very important aspects. First, "sustainable" efficiencies are those that can be continued without jeopardizing the safety, reliability or quality of utility activities and services. Second, "sustainable" efficiencies are generally expected to endure beyond rebasing, such that ratepayers will receive the benefit of the efficiencies during the period after rebasing has occurred.

There is a critical distinction to be made between "sustainable" efficiencies and short term cost cutting. Unlike sustainable efficiencies, short term cost cuts cannot necessarily be continued beyond the short term without jeopardizing the safety,

[18] *Natural Gas Regulation in Ontario: A Renewed Policy Framework*, *supra*, at pp. 2-3. (NGF Report)

reliability and quality of utility activities and services. Unlike sustainable efficiencies, short term cost cuts will not necessarily endure after rebasing.

Many parties to this proceeding have advanced arguments about the I Minus X approach to IR methodology. (As stated in Argument in Chief, Enbridge's previous IR plan was based on a formula using an Inflation index and an inflation coefficient and this type of formulaic methodology has been generally referred to as an "I Minus X" model). There is considerable discussion of the I Minus X methodology in the arguments of other parties, yet no-one has put forward any argument or reasoning to support a view that this methodology includes an incentive to single out "sustainable" efficiencies as distinguished from short term cost cutting.

In other words, one of the three criteria established by the Board for a multi-year gas rate regulation framework is the creation of "incentives for sustainable efficiencies", but nothing has been suggested in this case that would lead the Board to a conclusion that there any incentives inherent in an I Minus X formula aimed specifically at "sustainable" efficiencies in preference to, or in distinction from, short term cost cutting.

Arguments have been made to the effect that it is simply to be expected that utilities operating under IR will seek out sustainable efficiencies. CME argues, for example, that the "intent" of the three rate-setting methods described in the RRFE Report is to prompt distributors to achieve sustainable efficiencies.[19] BOMA argues that "the Board expects sustainable efficiency measures, as an integral part of IRM, not as a response to a separate incentive".[20]

The idea that sustainable efficiencies are simply to be expected of utilities operating under IR is squarely at odds with the clear indication in the NGF Report that one of the three criteria for an IR framework is "incentives" for sustainable efficiencies. It is a reasonable inference from the importance attached to "incentives for sustainable efficiency improvements" in the NGF report that the Board recognized a key proposition:

[19] Argument of CME, p. 24, para. 85.
[20] Submissions of BOMA, p. 16.

without a specific incentive for sustainable efficiencies, there is nothing inherent in the structure of a typical rate-setting model that would drive a regulated utility to give preference to sustainable efficiencies over short term cost cutting.

As explained in the evidence, Enbridge took guidance from the NGF Report and also from more recent documents that provide direction with respect to the evolution of the Board's approach to IR, in particular the RRFE Report. The RRFE Report of course provides an outline of the Custom IR method of rate-setting. While the RRFE Report leaves no doubt that this "rate-setting method" is "intended to be customized to fit the specific applicant's circumstances",[21] the report provides general guidance that includes commentary about the Board's expectations with respect to the nature of the evidence that will be filed in a Custom IR proceeding. Specifically, it is noted at a number of different places in the RRFE Report that the Custom IR method is to be based on five-year forecasts of costs and revenues.[22]

It is also made plain in the RRFE Report that the Board expects the five-year forecasts that form the basis of a Custom IR application to be subjected to a thorough review. Thus, for example, the RRFE Report says that the Board expects applicants for Custom IR to be committed to this methodology for the duration of the approved term, because Custom IR will require the expenditure of significant resources not only by the applicant, but also by the Board.[23] The RRFE Report also says that, because planned capital spending is expected to be an important element of a Custom IR application, this spending "will be subjected to thorough reviews by parties to this proceeding".

In light of the direction provided by the RRFE Report, Enbridge has filed extensive evidence supporting the forecasts upon which it relies for the purposes of its Customized IR application. Enbridge has also taken direction from the NGF Report and has included in its Customized IR application a proposed mechanism, the Sustainable

[21] RRFE Report, pp. 18-19.
[22] This can be seen in the RRFE Report, for example, at p. 13 ("distributor's forecasts"), at p. 18 ("five year forecast") and at p. 19 ("cost and revenue forecasts over a five year horizon").
[23] RRFE Report, p. 19.

Efficiency Incentive Mechanism (SEIM), that is specifically aimed at "sustainable" efficiencies. The SEIM is intended to work in conjunction with Enbridge's proposed Performance Measurement Framework, which, as discussed above, includes two reporting mechanisms, the Productivity Initiatives Report and the Performance Metrics Benchmarking Report.[24]

The extensive evidence filed by Enbridge in support of its forecasts gives the Board a solid factual foundation upon which to make findings about the appropriate parameters for the proposed Customized IR plan. The evidence regarding the SEIM and the Performance Measurement Framework shows that Enbridge has taken account of the guidance in the NGF report that an IR framework should include incentives for sustainable efficiencies.

In response to Enbridge's evidence, Board Staff contends, as part of one its two alternative proposals, that the Board should "impose a reduction to the revenue requirement of $20 million per year (total amount $100 million)".[25] Board Staff also offers submissions about a stretch factor of 0.6% that, it says, would translate into a reduction of $6.3 million to $7.8 million per year on revenue requirement (net of gas costs).[26]

The revenue requirement reductions suggested by Board Staff in final argument are troubling because they were not tested at all during the evidentiary phase of the proceeding so as to bring out for the Board even a bare minimum of evidence addressing whether or not the cost forecasts resulting from such reductions would be reasonable. Surely, if the expectation is that a Custom IR application will be grounded solidly on evidence of forecasts, then it is also to be expected that proposed changes to the applicant's forecasts should also have a solid grounding in the evidence. It is not logical or reasonable to expect an applicant for Custom IR to file robust evidence supporting its cost and revenue forecasts and yet to accept that forecasts supported by

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[24] See Ex.A2-11-2.
[25] Board Staff Submission, pp. 74-76.
[26] Board Staff Submission, p. 78.

extensive evidence will ultimately be changed on the basis of comments in final argument that have little or no evidentiary grounding.

Further, at no point in its submissions does Board Staff explain how the Board can come to the conclusion that the revenue requirement reductions proposed by Board Staff represent efficiencies that are “sustainable”. Indeed, the notion that IR should encourage cost reductions that are “sustainable” - rather than cost cutting that is arbitrary, or short term, or both - simply does not emerge as a strong theme from Board Staff’s submissions.

A word search of Board Staff’s submissions reveals that the word “sustainable” is used a total of 18 times. Of these 18 usages of the word “sustainable”, at least 11, if not more, are in the context of Board Staff’s discussion of Enbridge’s proposed SEIM and another is found in a quote from Enbridge’s Argument in Chief. One is left to wonder whether, if Enbridge had not proposed the SEIM, the concept of “sustainable” efficiencies would have entered into Board Staff’s thinking at all.

In a similar manner, intervenor arguments reveal that it is of little concern to these parties whether the IR plan for Enbridge actually has any incentive that is aimed specifically at sustainable efficiencies, in distinction from short term cost cutting. It is not that parties question the merits of a mechanism aimed specifically at sustainable efficiencies: Energy Probe, for example, says that some sort of mechanism to incent sustainable efficiencies is desirable;[27] APPrO says that “the concept of reducing the long term costs to customers has merit”;[28] and SEC says it has no doubt that Enbridge’s “intentions are good on this”.[29] Similarly, Board Staff commends Enbridge for

> …making an attempt to construct a solution to the tricky problem of incenting the generation of efficiencies so as to be long term and sustainable after the IR term has expired.[30]

[27] Final Argument of Energy Probe, p. 22.
[28] Written Submissions of APPrO, p. 43, para. 127.
[29] Final Argument of SEC, p. 61, para. 6.3.2.
[30] Board Staff Submission, p. 27.

Notwithstanding this support for the purpose underlying Enbridge's efforts to develop the SEIM, parties unhesitatingly jump on the notion that the SEIM should simply be rejected by the Board. Worse yet, with the exception of SEC, these parties that are so quick to reject the SEIM make no effort whatsoever to suggest any other way to incorporate within an IR model an incentive that is aimed specifically at sustainable efficiencies.[31]

In Argument in Chief, Enbridge pointed out (twice) that no-one involved in this case has suggested a better way to focus specifically on sustainable efficiencies than Enbridge's SEIM.[32] This observation was not disputed in any of the arguments delivered after Enbridge's Argument in Chief. Whatever its imperfections may or may not be, the SEIM is the only mechanism offered for the Board's consideration in this case that squarely addresses one of the three criteria for an IR plan set out in the NGF Report, namely, that such a plan should establish incentives for "sustainable" efficiency improvements.

SEC's argument puts forward a suggestion that falls short of anything that can be described as a "mechanism", but that at least addresses in some fashion the concept of an incentive for sustainable efficiencies. SEC's suggestion is as follows:

> If the Board wishes to provide something of this nature to Enbridge at this time, SEC suggests that the Board simply advise that, when Enbridge comes in for rebasing, it may be eligible for an additional incentive of up to $X million ($5 million, perhaps) to the extent that it can demonstrate at that time that its costs going forward have been reduced by initiatives implemented during IRM.[33]

SEC goes on to say that the actual amount and method of calculation of the additional incentive would be decided by the Board panel at the time of rebasing, taking into

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[31] In the alternative to its primary submission that the SEIM should be rejected by the Board, APPrO does offer some ideas for modifications to the SEIM: Written Submissions of APPrO, pp. 44-45, para. 132.
[32] Argument in Chief, pp. 12 and 70.
[33] Final Argument of SEC, p. 62, para. 6.3.4.

consideration factors such as the amount, nature and certainty of the future savings and "the savings already enjoyed during IRM".[34]

Had Enbridge come forward in this case with a proposal for an incentive to be considered by the Board at rebasing, leaving the parameters and criteria for such incentive to be addressed in the rebasing case, Enbridge would undoubtedly have been taken to task by at least some parties for not fully defining and developing its proposal.

Enbridge has of course made a proposal for a SEIM with defined parameters and criteria and it has gone further, in that it has refined the proposal to address comments made by others through the course of this proceeding. Enbridge submits that the Board should approve the proposed SEIM, or such variation of it as the Board deems reasonable.[35] To the extent that the Board feels that further consideration of any potential variation to the SEIM is needed or warranted, Enbridge reiterates the proposal made in Argument in Chief that a consultative process could be held over the next year to develop an appropriate SEIM.

In the event that the Board finds itself unable to accept any of the proposals made by Enbridge regarding the SEIM, Enbridge submits that the Board should at least adopt the suggestion made by SEC, so that the Customized IR plan will include some form of incentive aimed specifically at sustainable efficiencies. SEC's proposal could be adopted by the Board as presented, which would leave the mechanics and methodology of the incentive to be dealt with on rebasing, or, again, a consultative could be held, in this instance to bring more definition to the incentive approach suggested by SEC.

4. No Basis for Approving an Alternative Model

Enbridge understands that, in exercising its jurisdiction to "adopt any method or technique" for the fixing or approval of just and reasonable rates, the Board may choose to approve rates based on modifications to Enbridge's proposed Customized IR plan

[34] *Ibid*.
[35] A possible adjustment to the SEIM is described at p. 70 of Enbridge's Argument in Chief.

that are supported, where necessary, by the evidence. A number of intervenors argue, though, that, rather than approving the Customized IR plan with or without modifications, the Board should create an I Minus X IR framework for the purposes of fixing or approving Enbridge's rates.

As recognized by the Board from the outset of this proceeding, there are two essential conditions that must be in place before the Board can begin to create an IR framework other than that applied for by Enbridge. First, there must be a basis in the evidence for the Board to create an alternative ratemaking framework. Second, there must have been an opportunity during the proceeding for a full and fair testing of any such alternative ratemaking framework.

The first of these two essential conditions was explicitly addressed by the Board in its Decision on Need for a Preliminary Issue dated October 3, 2013. In that Decision, the Board said that it would not be restricted from establishing an alternative framework "provided that there was an evidentiary basis for it".[36] Although the Board made clear on October 3, 2013 that it would need an evidentiary basis in order to approve an alternative framework, no party led evidence proposing an alternative to the Customized IR plan.

The second essential condition was recognized by the Board when the Board approved the Issues List for this proceeding on November 5, 2013. There is a section of the Issues List that specifically pertains to Alternative Proposals. Section D of the Issues List, under the heading "Alternative Proposals" sets out the following issues:

> 33. With respect to any alternative IR plan proposed for Enbridge, does that proposal meet the Board's objectives for incentive regulation for gas distributors and is it appropriate?
>
> 34. With respect to each of the components of any alternative IR proposal, are those components appropriate?[37]

[36] Decision on Need for a Preliminary Issue and Procedural Order No. 2, October 3, 2013, p. 3.
[37] Decision on Issues List and Decision on Motion, November 5, 2013, Appendix "A", Issues List, p. 5.

In order for the Board to consider an alternative proposal, there would need to have been an opportunity for that proposal to be tested through the course of the proceeding against the issues set out in Section D of the Board-approved Issues List.

Intervenor arguments have completely overlooked the second of these two essential conditions, even though it was explicitly discussed in Enbridge's Argument in Chief. The issues set out in Section D of the Issues List were quoted in Argument in Chief and Enbridge went on to note that, because there has been no opportunity to test any alternative proposal in accordance with Issues 33 and 34, there is no evidentiary basis upon which the Board could establish an alternative ratemaking framework.[38] Intervenors did not respond to this point in their arguments and hence the point stands unchallenged.

There was no testing of an alternative model during the course of this proceeding because no party put forward a witness to testify in support of an alternative model. Instead, intervenors saved for argument their attempts to explain how the Board might find evidence to support approval of an alternative model.

SEC submits that the sources of "information" that the Board can use to create an I Minus X model for Enbridge are the outcomes of three other Board proceedings and the evidence of PEG.[39] As for the evidence of PEG, Dr. Kaufmann testified that he was not asked to prepare an alternative proposal and that he has not put forward an alternative proposal.[40] As for the other proceedings, SEC relies on the Settlement Agreement in Union's EB-2013-0202 case, the Settlement Agreement in Enbridge's EB-2007-0615 case and the 4th generation IRM for electricity distributors developed in the RRFE proceeding.

[38] Argument in Chief, pages 20-21.
[39] Final Submissions of SEC, pp. 49-50, para. 5.2.2.
[40] 4Tr.126.

CME puts forward an argument that relies on the same sources of information as SEC.[41] In addition, CME relies on a determination made "a few years ago" regarding an appropriate measure of inflation for gas distributors.[42]

It is apparent on the face of these submissions that the outcomes of other proceedings relied upon by SEC and CME cannot be assumed to provide any evidentiary foundation in this case. A determination of an inflation measure made by the Board "a few years ago", and determinations made in Enbridge's EB-2007-0615 case, cannot simply be assumed to have some relevance to issues under consideration by the Board in 2014. In order for the Board to place any reliance on the outcomes of any of the proceedings relied upon by SEC and CME for the purposes of creating an alternative IR model, evidence would be needed in this case about the extent to which those outcomes have any relevance or applicability in the circumstances of this case.

Thus, Enbridge submits that, in the absence of some evidence confirming their relevance and applicability, the outcomes of the proceedings relied upon by SEC and CME do not and cannot form an evidentiary foundation for the creation of an IR model in this case. And this is all the more so because:

(i) two of the outcomes are actually settlements, rather than Board decisions on litigated issues;

(ii) another of the outcomes is from an electricity proceeding, even though the applicant in this case is a gas distributor; and

(iii) one or more of the outcomes pre-date the application in this case by some years.

Furthermore, given that SEC and CME have attempted to cobble together the basis for an alternative model in final argument, their propositions about the evidentiary

[41] Argument of CME, pp. 21-22, paras. 69-72.
[42] Argument of CME, p. 21, para. 69.

foundation for such a model were not presented in a manner that allowed them to be tested during the evidentiary phase of this case.

Enbridge submits that the frailty of these belated efforts to offer an alternative model for the Board's consideration leaps out from the words of SEC's own arguments, such as the following:

(i) SEC says that the IR plan described in Union's EB-2013-0202 Settlement Agreement "has the potential to be" a good basis for the Board to establish rates;[43]

(ii) SEC says "[n]o doubt there are differences between Enbridge and Union Gas";[44]

(iii) SEC says "it would appear" that a particular "enhancement" to the Union plan solves a problem for Enbridge;[45]

(iv) SEC says that "[i]n the event that Enbridge has a strong preference for a revenue cap per customer structure, SEC believes that would be appropriate";[46]

(v) SEC does not assert that the PEG evidence provides a foundation for the creation of an IR model (not surprisingly, since PEG did not set out to do any such thing) -- instead, SEC says that the PEG evidence provides the foundation "to test the reasonableness" of a plan;[47] and

(vi) SEC says that "[e]veryone appears to agree that the basis upon which the 4th generation formula is derived is not directly applicable

[43] Final Argument of SEC, p. 51, para. 5.2.14.
[44] Final Argument of SEC, p. 13, para. 2.2.
[45] Final Argument of SEC, p. 52, para. 5.2.20.
[46] Final Argument of SEC, p. 54, para. 5.3.2.
[47] Final Argument of SEC, p. 53, para. 5.2.27.

> to gas distributors, at least with respect to productivity and stretch".[48]

It is evident from the wording of SEC's own submissions that, during the evidentiary phase of this case, there was not sufficient examination or testing of the basis upon which SEC seeks to propound an alternative model in its final argument.

When all is said and done, the only evidence actually on the record in this proceeding regarding an I Factor, or "I", and an X Factor, or "X", is the evidence of Concentric Energy Advisors (Concentric).[49]

For all of these reasons, Enbridge submits that the Board should not accept assertions that the IR model described in Union Gas' Settlement Agreement (the Union Gas Settlement) should be applied to Enbridge or that specific aspects of the Union Gas Settlement should simply be applied to Enbridge. The Board's determination of the appropriate IR model for Enbridge, or of particular aspects of Enbridge's IR model, should not simply apply the outcome of another case, without an evidentiary foundation for the relevance or applicability of that outcome to Enbridge's circumstances.

Indeed, although the RRFE Report acknowledges that Custom IR allows a rate-setting method to be customized to fit the circumstances of a particular electricity distributor, the notion of imposing on a gas distributor the outcome of a settlement agreement reached by another gas distributor is the very antithesis of a "customized" approach.

As well, it is important to note that Enbridge was not a party to the Union Gas Settlement. The assumption that matters agreed to in a Union Gas Settlement can simply be applied to Enbridge, without evidence as to their relevance or suitability, has the effect of treating the Union Gas Settlement as if it were a generic hearing that resulted in determinations applicable to Enbridge.

[48] Final Argument of SEC, p. 53, para. 5.2.28.
[49] Ex.A2-9-1.

Of course, an assumption that the Union Gas Settlement can be treated like the outcome of a generic hearing with determinations applicable to Enbridge is faulty on a number of grounds: the Union Gas proceeding was not a generic one, there was not actually a hearing on the elements of the model because a settlement was reached and Enbridge was not a party to the settlement.

Moreover, there was of course no notice given to Enbridge that it should participate in the Union Gas case in the expectation that there would be generic determinations made in Union Gas' proceeding that would be applicable to Enbridge. But the implication of intervenor arguments is that Union Gas' plan, or aspects of it, should be applied to Enbridge, even though Enbridge had no notice that the outcome of the case would be treated like a generic determination applicable to Enbridge; Enbridge accordingly did not participate in the development of Union Gas' plan; and Enbridge's circumstances accordingly were not brought forward for consideration during the development of Union Gas' plan.

5. Benchmarking and External Evidence

Board Staff's submissions include an extensive discussion of benchmarking. These submissions flow from Board Staff's assertion that, in developing the forecasts for a Custom IR plan, a utility should use "the most sophisticated tools – in-house expertise, third party engineering studies, and benchmarking to satisfy the regulator and ratepayers that the forecasts are reasonable".[50] The arguments of a number of intervenors also address benchmarking or an independent review of forecasts.

Board Staff's starting point for its submissions regarding "Requirements Applicable to Enbridge's Proposed Customized IR Plan" is a particular excerpt from the section of the RRFE Report that explains the Custom IR approach. The words of this excerpt from the RRFE Report merit a little more attention than was paid to them in Board Staff's submission, so the excerpt is repeated below:

[50] Board Staff Submission, p. 12.

> The allowed rate of change in the rate over the term will be determined by the Board on a case-by-case basis informed by empirical evidence including:
>
> - the distributor's forecasts (revenues and costs, including inflation and productivity);
>
> - the Board's inflation and productivity analyses; and
>
> - benchmarking to assess the reasonableness of distributor forecasts.
>
> Expected inflation and productivity gains will be built into the rate adjustment over the term.
>
> (Emphasis added.)

Underlining has been added to this excerpt to emphasize, if emphasis be needed, a notable point about the Board's wording. There are three types of empirical evidence referred to in this passage from the RRFE Report. The description of each of the first two types of empirical evidence begins by stating specifically who is expected to provide the evidence. The forecasts of revenue and costs, including inflation and productivity, are to be those of the distributor. The inflation and productivity analyses are to be those of the Board.

The wording of the third type of empirical evidence does not follow the pattern established by the wording of the first two categories. The words describing the third category do not explicitly indicate who is expected to provide "benchmarking" evidence. This is the case, as well, with the Rate-Setting Overview in Table 1 of the RRFE Report: under the Custom IR heading, Table 1 refers to "the distributor's" forecasts, "the Board's" analyses and "benchmarking".[51]

Given that the Board specifically directed its mind to the source of evidence in each of the first two categories, it seems to follow that the Board deliberately left open the source of the benchmarking evidence that is the third category of empirical evidence

[51] RRFE Report, p. 13.

referred to in the above passage from the RRFE Report. There is no presumption in the RRFE Report that benchmarking evidence must be filed by an applicant. Instead, the words of the RRFE Report relied upon by Board Staff leave it open that an applicant may provide benchmarking evidence. The words also leave it open that, in the absence of benchmarking from the applicant - or if for any other reason Board Staff chooses to file benchmarking evidence - the evidence may be provided by Board Staff. And the words leave it open that benchmarking evidence may be provided by any other party.

Board Staff's submissions include another quotation about third party experts from the RRFE Report. The context of this other quotation is the Board's discussion of the review and assessment of distributor asset management and network investment plans. The words quoted by Board Staff indicate that the Board sees merit in receiving the evidence of third party experts as part of a distributor's application, or <u>retaining its own third party experts</u>.[52] (Emphasis added.) Again, there is no presumption in these comments by the Board that third party expert evidence must be provided by applicants.

As the first Custom/Customized IR applicant, Enbridge did not have available to it the views expressed by Board Staff (and other parties) in this case about expectations for Custom IR applicants. Enbridge did, though, take guidance from the RRFE Report and it did, in fact, file benchmarking evidence from an independent expert, Concentric.

Concentric's work in this area starts from the premise that, in order to promote productivity and efficiency in utility operations, the Board, the Company and stakeholders require an understanding of the baseline starting point, and realistic expectations for what is possible in the future. To create this baseline, Concentric conducted a series of analyses.[53] First, Concentric benchmarked Enbridge's performance across a variety of operating and financial metrics over the 2000 to 2011 period in relation to a group of gas distribution peer group companies. Second, Concentric measured the productivity of the industry and Enbridge over the same period

[52] Board Staff Submission, p. 32, quoting from RRFE Report, p. 37.
[53] The results of Concentric's work are found in its report at Ex.A2-9-1.

using a total factor productivity "TFP" analysis that measures the efficiency of a utility in converting all of its inputs (labour, capital and materials) into outputs (customers serviced). Third, Concentric also performed a more focused analysis on O&M expenses only (excluding capital), with a partial factor productivity (PFP) analysis.

With each of the three analyses, Concentric compared Enbridge's costs and productivity relative to its industry peers. For these analyses, Concentric utilized objective criteria to select peer companies similar to Enbridge while allowing for a sufficient number of companies to ensure that the analyses would be robust and provide an appropriate perspective for industry comparisons. These criteria resulted in an Industry Study Group of 28 U.S. natural gas utilities comprised of 48 individual operating subsidiaries, and 6 Canadian natural gas utilities. A subset of 25 U.S. natural gas utilities and 42 operating subsidiaries was used in the productivity analysis, and further narrowed to a 7 company subgroup of large and faster growing utilities.

As discussed in section IV of Concentric's report, "Evaluation of EGD's Productivity",[54] Concentric's benchmarking, TFP, and PFP analyses demonstrate that: (a) EGD is currently an efficient utility, (b) EGD has continued to improve its performance relative to its industry peers, and (c) EGD improved its productivity during the 1st Generation IR plan (2007-2011) compared to the pre-IR Plan period (2000-2007) relative to its industry peers.

The outcome of Enbridge's efforts to support its application with benchmarking evidence was an all-out offensive against the work of Concentric and, more particularly, Mr. Coyne. This attack on a highly respected and experienced witness covered everything from allegations about Mr. Coyne's "independence"[55] to assertions about the number of peer reviewed articles he has published.[56] Even though Mr. Coyne was accepted as an expert witness, prior to which no challenge to his expertise was made, VECC's Final

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[54] Ex.A2-9-1, pp. 20-42.
[55] 3Tr.3-34.
[56] Final Argument of VECC, p. 12.

Argument attempts to put into issue Mr. Coyne's expertise.[57] Parties also attacked virtually every aspect of the work that Concentric performed. For example, issues were raised about Concentric's peer group selection, scope of examination and benchmarking methodology.[58]

Enbridge takes issue with all of the various attacks upon Mr. Coyne and Concentric's work. The fact remains that Concentric presented a solid foundation of work to assist the Board with an understanding of the comparative efficiency of Enbridge against both a broad and a focused set of industry peers. Board Staff refers to benchmarking work performed on data for Ontario's electricity distributors, yet will not acknowledge that this analysis is not possible with the data available for gas distributors. Nor will Board Staff acknowledge that no alternative studies have been provided here or in other jurisdictions that would prove more reliable. Enbridge submits that the analysis carried out by Concentric meets or exceeds the standards that can reasonably be expected of a gas distributor.

Many of the arguments and comments made by others about benchmarking have already been addressed in Concentric's response to the PEG Report[59], and in Mr. Coyne's testimony.[60] In Enbridge's view, it is not a productive or useful exercise to prolong the benchmarking debate by embarking here on a detailed response to all of these arguments and comments.

On the contrary, it has emerged clearly from the wide-ranging benchmarking debate that there is no magic power to be attributed to benchmarking that will unequivocally validate a utility's forecasts. Instead, it can be seen from this case that an attempt by a Custom/Customized IR applicant to put forward benchmarking evidence is most likely to give rise to controversy and wrangling that, in the end, throws into question whether the benchmarking debate can be adequately resolved for the Board. These analyses are

[57] Final Argument of VECC, pp. 11-12.
[58] See, for example, Board Staff Submission, pp. 20-32.
[59] Ex.I.A1.EGDI.CME.1, Attachment 1.
[60] See, for example, the discussion between Board Staff Counsel and Mr. Coyne at 3Tr.71-101.

inherently subject to data limitations, arguments about peer comparability and the judgment of experts.

In any event, as discussed above, the RRFE Report does not presume that benchmarking evidence must be provided by a Custom IR applicant and it most certainly does not presume that only an applicant can provide benchmarking evidence. To the extent that there were perceived to be any shortcomings with Concentric's evidence, Board Staff could have filed benchmarking evidence and indeed any intervenor could have done so. This would have been a more constructive, and indeed productive, approach to the first Customized/Custom IR case than the all-out offensive against Concentric and Mr. Coyne that occurred in this case.

During the testimony of the joint expert witness panel, there was considerable discussion about the work done by Concentric. Through the course of this testimony, Dr. Kaufmann's criticism of Concentric's work focused in on his view that Concentric should have undertaken further analysis that looked at O&M and capital costs together.[61] When asked by Ms Chaplin about the need to look at O&M and capital spending together, Mr. Coyne's response was as follows:

> Yes, I do agree with that. And then it becomes a measurement issue. With O&M, you can measure very well. Although utilities report their O&M expenses differently, and separating out some costs can be challenging, you generally feel like you have a fairly good measure of what they're spending in a year.
>
> And then when you to turn to capital, this is where so much of the I-X analysis breaks down. Every analyst – not just before this regulatory body and other regulatory bodies, but economists that do this for the nation – struggles with capital, because you're taking a large capital stock and you're trying to basically determine from those numbers how much of that capital stock gets used in a given year.[62]

Mr. Coyne went on to explain that there are imperfect measurement techniques that analysts use to grapple with the problem that he described. Concentric used the most

[61] 4Tr.28.
[62] 4Tr.34-35.

common approach, the geometric decay method, but Mr. Coyne was quick to note that this is an imperfect method.[63] Mr. Coyne was comfortable with the notion of combining a capital spending trend analysis (based on trends of additions to, and removals from, capital stock) with O&M to develop the Total Factor Productivity analysis. He expressed his concern, however, about taking an imperfect number from the capital spending trend analysis and adding it to an O&M number, with the thought that this somehow might produce a reliable number for total spending in a particular year.[64]

Board Staff rely in argument on an undertaking response in which a calculation was carried out to produce the very numbers that Mr. Coyne said would not be reliable.[65] That is to say, although Mr. Coyne testified that adding an imperfect capital spending number to an O&M number cannot be expected to produce a reliable result, Dr. Kaufmann saw fit to do this calculation.[66] Given Mr. Coyne's evidence that the result of the calculation is suspect, Enbridge submits that the undertaking response has not advanced an understanding of any issue, other than perhaps to show that Dr. Kaufmann is willing to go ahead in circumstances where Mr. Coyne has a concern about making sure that the Board is able to work with reliable data.

Mr. Coyne also stressed the difference between the data available for the Ontario electricity distributors compared to that available for any reasonably-sized sample of gas distributors. Indeed, both Mr. Coyne and Ms Frayer repeatedly took issue with the availability of data from gas distributors to carry out the analysis suggested by Dr. Kaufmann.[67]

Of the three witnesses on the joint expert panel, Dr. Kaufmann was the only one who did not share these concerns about the type of analysis that he proposed. As far as the availability of data is concerned, he said that he is very familiar with the data for both

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[63] 4Tr.35.
[64] 4Tr.35-36.
[65] Board Staff Submission, pp. 28-29.
[66] Response to Undertaking TCU 1.11x.
[67] See also 3Tr.67-69; 3Tr.138-140; and 3Tr.141-142.

gas and electric utilities here in Ontario.[68] He went on to say that it was a very long and involved data collection and analysis exercise to put together the data needed for electricity distribution "and we wouldn't need to undertake anything like that for a gas distribution study".[69] There was simply no doubt in Dr. Kaufmann's mind that the gas distribution data are far better for benchmarking purposes than the electricity distribution data in Ontario.[70]

In short, Mr. Coyne did what any responsible and reasonable expert would do: he remained intent on providing reliable evidence to the Board and, given the shortcomings of the methodology and his issues with the availability of data, he took the analysis only as far as he thought he could go within these limits. Dr. Kaufmann, for his part, was clearly very confident that he could have gone further with the analysis – but he did not make any effort to do so. Nor did Dr. Kaufmann present any analyses filed by him or by PEG in any other jurisdiction that included the type of gas distribution benchmarking contended for by him in this case.

This issue was pursued with Dr. Kaufmann during cross-examination and the following exchange occurred:

> MR. CASS: Now, just on the subject of benchmarking, you seem to be the one person on this panel who believes that you have access to the data you would need to do the sort of econometric benchmarking that you are talking about.
>
> Have you told Board Staff that you could do that?
>
> DR. KAUFMANN: Have I told Board Staff that I could do econometric benchmarking? I believe that I have, yes.
>
> MR. CASS: But they didn't instruct you to do that in this case?

[68] 4Tr.38.
[69] 4Tr.38-39.
[70] 4Tr.39.

> DR. KAUFMANN: Well, it was – I told them that in the last two or three weeks.[71]

Surely, the incongruity of this situation, especially when taken in the context of arguments now made by Board Staff and intervenors, is readily apparent. Board Staff's argument relies heavily on wording in the RRFE Report about "benchmarking". The RRFE Report does not establish a presumption that benchmarking evidence must be provided by an applicant and it leaves open whether such evidence might come from an applicant, Board Staff or any other party. Concentric provided benchmarking evidence on behalf of Enbridge. Board Staff's witness criticized Concentric's evidence because he alone among the experts was of the view that the analysis could have been taken further. But he did not do so, apparently due to the fact that he did not make Board Staff aware of his position in this regard until shortly before the hearing,[72] and he did not bring forward any evidence provided in other jurisdictions that would meet this standard. Although it would have been well within the wording and intent of the RRFE Report if this witness had provided his own benchmarking evidence, the arguments of Board Staff and intervenors instead seek to turn the wording of the RRFE Report around against the party that did file benchmarking evidence, Enbridge.

The challenge to Enbridge's benchmarking evidence is a hollow and unconvincing one when the witness who says that the analysis could have gone further did not actually attempt to do the work that, if he had been able to do it, would have proved his point. In essence, the position of Board Staff and other parties is that the party that did file benchmarking evidence should have done more, even though the Board Staff witness who says he could have gone further did not attempt to do so. To support this incongruous position, Board Staff relies on the wording of the RRFE Report. For the reasons set above, the argument that the wording of the RRFE Report should, or even can, be interpreted so as to support such an argument does not stand up to scrutiny.

[71] 4Tr.128.
[72] One can only wonder how this could have happened, since PEG's assessment of the Customized IR plan, including comments on the benchmarking evidence, was filed in October of 2013.

On a more constructive note, the Company believes that it would be helpful to the Board if there could be common understanding between Enbridge and stakeholders about what benchmarking information is available and appropriate for future use. To that end, Enbridge commits that upon the conclusion of this case, it will proceed to work on a benchmarking study (that attempts to address both capital and O&M together). Specifically, Enbridge will carry out benchmarking for 2014 and 2015, and, if it can be done on a timely basis, 2016. Then, during the term of the IR plan, Enbridge will hold a consultative with stakeholders to allow their review of the benchmarking study and to get their feedback. Based on the results of the consultative, Enbridge will develop a benchmarking study to be filed on rebasing which, Enbridge hopes, will utilize a methodology that can be accepted by all parties, including Board Staff and its expert.

6. Enbridge Requires a Customized IR Plan Approach

As already discussed, a common theme within intervenor arguments is that Enbridge does not require the Customized IR plan, and instead should be subject to an IR plan which uses an I Minus X approach.

Enbridge's 1st Generation IR model employed an I Minus X escalator, using a revenue cap per customer calculator and Y Factors for specific incremental projects not subject to the revenue escalator.[73] Enbridge has filed detailed evidence explaining why it requires the Customized IR Plan approach, and how an I Minus X IR plan similar to its 1st Generation IR plan will not work in Enbridge's current circumstances.[74]

Over the coming five-year period, Enbridge's business needs present very significant challenges for its rate regulation framework, including, as described in Argument in Chief[75], capital spending pressures related to safety and integrity issues, very large capital projects such as the GTA Project and WAMS, growing depreciation costs, and increased uncertainty about future capital spending requirements. The capital spending

[73] Ex. A2-1-3, p. 3.
[74] See, for example, Ex.A2-1-1 and A2-1-3.
[75] Argument in Chief, pp. 21-38.

requirements faced by Enbridge are, in large part, driven by aging infrastructure, which is not an uncommon issue. Like utilities across North America, Enbridge must deal with aging infrastructure and, as is particularly the case with natural gas distribution, increased emphasis on safety and integrity. There are costs associated with taking action to address these issues and the costs do not go away if the work is deferred. Deferral of the work just means more costs that must be paid in the future in addition to whatever the future costs would otherwise have been. In addition to the aging infrastructure issues, Enbridge's capital spending requirements are also driven by ongoing customer growth, upcoming very large projects and by circumstances that are particular to Enbridge.

The evidence is that the escalation factor under an I Minus X methodology that would be required to meet Enbridge's challenges over the next five years would be well in excess of traditional values for "I" and "X".[76] As explained, assuming that the Board approved Y Factors for the GTA and Ottawa LTC Projects within an I Minus X plan, Enbridge would require an escalation factor (I Minus X result) of more than 3.3% per year to be able to earn a fair return.[77] Even assuming an X Factor of zero, as Concentric recommends[78], this escalation factor is much higher than expected inflation. Further, if one assumes a different (higher) X Factor, then it is clear that Enbridge is not able to achieve a Fair Return. This is seen within the response to Board Staff Interrogatory 69, which shows that, in a scenario with an I Factor of 1.7% and an X Factor of 1.0%, the Company would be 300 basis points below the forecast Board ROE by the end of the IR term.[79]

The conclusion that an I Minus X plan will not work for Enbridge, even with Y Factors for major projects, was confirmed by Concentric, who explained that:

> It is Concentric's assessment that an I-X escalation formula does not provide adequate recovery of capital-related costs during the 2014 to 2016

[76] 2Tr.20 and 27-28; Ex. A2-1-3, p. 18.
[77] Ex.A2-1-3, pp. 7-16.
[78] Ex.A2-9-1, p. 39.
[79] Ex.I.D33.EGDI.STAFF.69.

> period. …. Only Rate Option 4, a Customized IR plan with recovery of capital-related costs matched to EGD's projected capital-related revenue requirements adequately covers the costs of EGD's base capital spending and GTA and Ottawa reinforcement projects.[80]

A main problem with an I Minus X approach in Enbridge's current circumstances is that it will not accommodate the Company's increases in depreciation expense. This was addressed in Argument in Chief.[81] As explained in evidence,

> Another cost pressure relates to the fact that the Company's depreciation expense is forecast to grow, on average, almost 6% annually over the coming years. This is a function of past capital investments and increasing capital expenditures. Depreciation represents almost a third of the estimated Allowed Revenue, but it is growing about twice as fast as the remaining elements.[82]

The pre-filed evidence went on to explain that Enbridge's depreciation expense cannot be accommodated in an I Minus X ratemaking plan.[83] The evidence summarized this point in the following manner:

> Assuming that most other cost elements are growing at close to inflation, revenue necessarily would need to grow at a rate greater than inflation for the Company to earn the Allowed Return. As explained at Exhibit A2, Tab 1, Schedule 3, the cost pressures from depreciation expense are not accommodated within a traditional I-X model, and are a main contributor to Enbridge's decision to proceed with this Customized IR model.[84]

In his oral evidence, Mr. Culbert explained why the impact of depreciation during the term of the proposed plan is a much more significant concern than it was under the previous IR plan.[85] Within the 1st Generation IR term, growing depreciation costs were accommodated by the fact that the cost of debt was declining versus the amount included within the base revenue requirement. The Company does not expect the

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[80] Ex.A2-9-1, pp 8-9. See also Mr. Coyne's testimony at 4Tr.28-29, where he explains that "We tested the forecast revenue requirement for Enbridge over the five-year period against that I-X, and as we well know, they don't match. And the reason they don't match is that Enbridge has been one of the fastest growing utilities in this group. …"
[81] Argument in Chief, pp.13-14 and 18-19.
[82] Exhibit A2-1-1, p. 23, para. 67. See also Exhibit A2-1-3, pp. 17-18, paras. 33-35.
[83] Exhibit A2-1-3, pp. 17-18, paras. 33-35.
[84] *Ibid.*
[85] 2Tr.25.

same circumstances to prevail over the coming years[86] (indeed, given the current level of debt costs, the same level of decline as seen between 2008 and 2012 would not be possible).

No party within this proceeding has led evidence, or even advanced argument, to refute the Company's evidence that its growing depreciation costs cannot be accommodated within an I Minus X type of model.

Intervenors do take issue, though, with Enbridge's position that increased capital spending requirements are an important factor driving the need for the Customized IR plan.[87] The basic premise for that position is the contention that forecast Core Capital spending in the coming years is not out of line with the actual spending in 2013.[88] Stakeholders also assert that Enbridge's Core Capital spending requirements for 2014 to 2018 are not "lumpy".

These arguments miss the key point entirely.[89]

The Company's Core Capital spending requirements that are included within Allowed Revenues are smooth because Enbridge has taken the risk of "variable costs" onto itself.[90] It is surprising that Enbridge is implicity criticized for this assumption of risk within the intervenor arguments which assert that the capital spending profile is not lumpy.

More importantly, Enbridge's 2013 Board-approved capital budget of $386.6 million (exclusive of major reinforcement projects) is significantly below the actual spending for that year, which totaled $441.6 million.[91] That is a very significant problem in the

[86] 2Tr.125.
[87] See, for example, Final Argument of Energy Probe, pp, 5 to7.
[88] *Ibid*.
[89] In this regard, Enbridge notes that each of the graphs created within the Final Argument of Energy Probe would look quite different if the amount of capital spending recovered within rates was included, as compared to the depiction of actual spending that is provided.
[90] 5Tr.15-17.
[91] Ex.B2-1-1, p. 5 describes the gap between the 2013 Board-approved capital budget and actual spending requirements. The final actual 2013 capital spending amount is set out at Ex.J5.6.

context of an I Minus X type model, where 2013 is the "base year". Under an I Minus X type model, the capital spending amount of $386.6 million that would be included within Enbridge's base rates or revenue requirement that is adjusted each year will be substantially below the Company's future capital spending requirements. Therefore, there will be a substantial mis-match between costs and revenues for a very large portion of the Company's activities over the 2014 to 2018 term. This is an important reason why an I Minus X type model will not work for Enbridge. The "mis-match" or gap would become much greater if there was no Y Factor treatment for Enbridge's major projects.

Proof that the forecast spending requirements that will be under-recovered are reasonable and real is found in: (i) the voluminous evidence and testimony in this proceeding[92]; and (ii) the fact that Enbridge actually spent to the $440 million level in 2013, even with the knowledge that the financial implications of 2013 capital overspending will not be recovered in rates until the next rebasing in 2019.[93]

7. Customized IR Plan is Consistent with Building Blocks Models

A common refrain within intervenor submissions is to dismiss the parallels between the Customized IR model and the Building Blocks models used elsewhere.[94] This approach relies on a single paragraph of Dr. Kaufmann's report for the proposition that the Building Blocks model that Enbridge has relied upon is one that the UK energy regulator has abandoned because of poor incentive properties.[95]

This line of argument is an immense oversimplification of the Building Blocks models that are in use in both the UK and Australia. The basic form of Building Blocks has not changed, and as explained at length in two reports filed by LEI, the Customized IR model is closely related the Building Blocks models used in both Australia and the UK.[96]

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[92] Discussed below in sections of the Reply Argument addressing budget forecasts.
[93] Ex.B2-1-1, p. 5.
[94] See, for example, Final Argument of VECC, p. 12 and Final Argument of CCC, p. 9.
[95] Ex.L-1-2, p. 5.
[96] Ex.A2-10-1 and Ex.I.A1.EGDI.CME.1, Attachment 2.

There is one chapter in the first LEI report entitled, "What has been the practical experience of building blocks"; another chapter addresses the "Evaluation of Enbridge's Customized IR Plan in the Context of a building blocks framework". At the outset of that chapter, LEI notes that:

> Enbridge's Customized IR plan has the same overarching characteristics of IR plans in jurisdictions using a building blocks approach that is a multi year fixed term, [and has] built in productivity measures and other incentive features. The application of an ESM complements the incentives built into the plan, providing an incentive for a utility to improve its efficiency but also to allow customer to share in the benefits, and furthermore safeguard consumers if there is actual under-spending of allocated capital investment in the allowed revenue amounts during the term of the plan.[97]

More specifically, LEI has concluded that the approach taken by Enbridge is consistent with Building Blocks models currently being used in that it involves the setting of overall budget objectives by management, detailed budget reviews, comparison of costs with past performance to determine reasonableness, and preparation of benchmarking and TFP analysis to gauge the reasonableness of the Customized IR plan.[98]

As explained by LEI in an Interrogatory response, the Building Blocks ratemaking model has strong incentive properties, which are also present within the Customized IR model:

> … a cost-of-service regulatory regime has weak motivations for a utility to pursue productivity gains as revenues collected from customers will be set on the basis of costs. In contrast, a building blocks approach is a recognized form of incentive ratemaking where actual costs and revenues are intentionally and explicitly decoupled. Under a building blocks approach, annual revenue amounts are presented for each year of the term of the regulatory period, reflecting expected operating costs net of estimated productivity goals. Once the IR plan has been approved, these annual revenue amounts set the rates that will be recovered from customers. The regulated utility takes on the risk of the capital expenditure and operating costs exceeding the annual revenue amounts over the term of the IR plan. This same risk serves to motivate the utility – if it can achieve incremental efficiency gains and lower its actual total costs of

[97] Ex.A2-10-1, p. 14.
[98] Ex.A2-10-1, p. 15.

> operation, it will see its returns increase. Therefore, under the building blocks approach, the revenues are decoupled from actual operating costs.[99]

LEI specifically responded to the criticism from Dr. Kaufmann that Enbridge's version of a Building Blocks model fails to contain the same incentive qualities as the current UK model, which includes an "Information Quality Incentive" (IQI).[100] As explained by LEI, even with the IQI the essential Building Blocks foundation used by the UK regulator has not changed:

> First, it is important that PEG's description of the IQI is corrected. The IQI is not meant to "potentially reward utilities for keeping capital cost projections relatively low" as claimed by PEG in its Assessment. More accurately, the aim of the IQI mechanism is to "encourage companies to submit more accurate expenditure forecasts to Ofgem." We believe that the ESM, coupled with all the dimensions of the Customized IR plan such as the five year term and the SEIM, also reinforce this same objective.
>
> Second, the IQI is only one component of the IRM and the presence of the IQI (or lack thereof) does not change the essential building blocks foundation. The IQI, in and of itself, has not been the sole source of improvement in incentive properties in UK's performance-based ratemaking regime. Notably, even Ofgem has indicated that the IQI may not be a permanent feature of its performance-based ratemaking regime in the future.
>
> ….
>
> Furthermore, implementation of the IQI mechanism is not simple. According to Ofgem, there were a number of concerns that the IQI itself could lead to unintended consequences, including by way of inappropriately representing management as risk neutral. In addition, given the significant amount of regulatory effort needed to design a similar scheme, this may not be a cost beneficial proposition in Ontario, especially for purposes of establishing an IR plan for one utility.[101]

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[99] Ex.I.A1.EGDI.SEC.36.
[100] As explained in LEI's response to the PEG Report, "there are no substantial changes with respect to how capex will be dealt with under the [UK] model and under the revised Customized IR proposed by EGD.": Ex.I.A1.EGDI.CME.1, Attachment 2, p.11.
[101] Ex.I.A1.EGDI.CME.1, Attachment 2, pp.11-13 (footnotes omitted). As noted by LEI at p. 13 of Ex.I.A1.EGDI.CME.1, Attachment 2, PEG itself acknowledged that the IQI approach would be difficult to implement for Ontario electricity utilities, because separate capex benchmarks would need to be developed for more than 80 distributors." (reference to Ex. L-1-2, p.59)

LEI's reports also provide information about the Building Blocks model used in Australia, which again is similar to the Customized IR model. LEI concludes that:

> Given the experiences in both the UK and Australia with building blocks, and the specific considerations of IR mechanisms that would be workable in the context of the Board's regulation of EGD, we believe that the building blocks approach used in EGD's Customized IR plan is consistent with the Board's objectives and should produce strong incentives for Enbridge to seek out productivity gains.[102]

No party has in any way responded to LEI's evidence.[103] Instead, all that is done is to rely on a single passage from the PEG report in response. In Enbridge's view, this means that the LEI evidence stands largely unchallenged for the proposition that the Customized IR model is consistent with a Building Blocks approach. The linkage between Building Blocks models in use elsewhere and the Customized IR model is persuasive support for the appropriateness of the Customized IR model.

8. Customized IR Plan Meets the RRFE Requirements

As Enbridge explains within its prefiled evidence[104], testimony[105] and Argument in Chief[106], in developing the Customized IR plan the Company took guidance from the Custom IR method within the RRFE Report. That is not to say that the Customized IR plan is an exact replica of the Custom IR method. Instead, the Company has reviewed the Board's description of the Custom IR method, and has used that to inform the Enbridge-specific model that has been created. Enbridge does not assert that the RRFE Report, which sets out the Board's approach to regulation of electricity distributors, applies directly to gas distributors. However, it seems fair to assume that the Board's views as to the appropriate framework for regulation, including ratemaking,

[102] Ex.I.A1.EGDI.CME.1, Attachment 2, p. 14.
[103] It appears that the only references to LEI within the almost 500 pages of submissions are a paragraph within p. 9 of the Board Staff Submission describing the LEI evidence, and a sentence at p.20 of the Final Argument of Energy Probe indicating that LEI's witness believes that the Customized IR plan is a Building Blocks model, as compared to Cost of Service.
[104] See, for example, Ex.A2-1-1, pp. 10 and 29.
[105] See, for example, 1Tr.10-11.
[106] See, for example, Argument in Chief, pp. 14-16.

that applies to Ontario electricity distributors would be influential to the Board's views about regulation of Ontario gas distributors, while respecting inherent differences between the two.[107]

The description of the Custom IR method within the RRFE Report indicates that the Custom IR method is conceptual, and that details of how the model will work will be determined within individual rate applications.[108] One thing that is clear, though, is that it is up to the distributor to choose which of the RRFE rate-setting methods it wishes to use:

> Each distributor may select the rate-setting method that best meets its needs and circumstances, and apply to the Board to have its rates set on that basis.[109]

Contrary to the implication of some intervenor submissions[110], there is no extraordinary onus on a distributor to prove eligibility for the Custom IR method. There is no statement within the RRFE Report indicating that there is a "default" rate-setting method that will apply unless the distributor can prove that only the Custom IR model will work for that distributor.

In any case, as described in the previous section of this Reply Argument, it is clear that a traditional I Minus X type IR method will not accommodate Enbridge's circumstances over the coming years, and that a Custom IR type approach is more appropriate.

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[107] 2Tr.14-15. Enbridge disagrees with VECC's contention that it is "highly questionable" that the Board intended to extend the same ratemaking treatments within the RRFE to gas distributors. (Final Argument of VECC, p. 8). VECC does not elaborate on its reasoning and provides no basis for the notion that differences between the infrastructure needs of gas and electricity distributors might somehow throw into question the availability of a customized IR approach to gas distributors. There is no basis for concluding that gas infrastructure needs are so fundamentally different from electricity infrastructure needs that a gas distributor should simply take no guidance from the RRFE Report.

[108] RRFE Report, pp. 18-19.

[109] RRFE Report, p. 9.

[110] See, for example, Argument of CME, p. 4.

Board Staff agrees that Enbridge's circumstances are consistent with the application of the Custom IR framework.[111] Further, Enbridge's witnesses clearly explained how Enbridge meets the expectations of the Custom IR method in response to Ms Chaplin on the second day of the hearing.[112]

Within the following pages, Enbridge provides more details around how its Customized IR application is consistent with the requirements for the Custom IR method set out in the RRFE Report.

a. What are the RRFE Requirements for Custom IR?

Intervenor submissions point to a variety of items that are said to be important parts of a Custom IR model. None of them focus upon what the Board said within the RRFE Report as it introduced and described the Custom IR model.

Under the heading "Custom IR", in the section titled "Description of the Three Rate-setting Methods", the Board introduced this new method as follows:

> In the Custom IR method, rates are set based on a five year forecast of a distributor's revenue requirement and sales volumes.[113]

After indicating that the nature of the Custom IR method and associated rate orders may vary, because the rate-setting method will be customized to an applicant's circumstances, the Board indicated that:

> The Custom IR method will be most appropriate for distributors with significantly large multi-year or highly variable investment commitments that exceed historical levels. The Board expects that a distributor that applies under this method will file robust evidence of its cost and revenue forecasts over a five year horizon, as well as detailed infrastructure investment plans over that same time frame. In addition, the Board expects a distributor's application under Custom IR to demonstrate its

[111] Board Staff Submission, p. 11. The symmetry between the Custom IR method and Enbridge's Customized IR plan is discussed in more detail below.
[112] 2Tr.149-152.
[113] RRFE Report, p. 18.

> ability to manage within the rates set, given that actual costs and revenues will vary from forecast.[114]

The Board then discussed the way that rates will be set under the Custom IR method, under the heading Annual Adjustment Mechanism, stating that:

> The allowed rate of change in the rate over the term will be determined by the Board on a case-by-case basis informed by empirical evidence including:
>
> - the distributor's forecasts (revenues and costs, including inflation and productivity);
> - the Board's inflation and productivity analyses; and
> - benchmarking to assess the reasonableness of distributor forecasts.
>
> Expected inflation and productivity gains will be built into the rate adjustment over the term.[115]

What is clear from all of the foregoing is that the distributor's forecasts of costs and revenues over the IR term is the key item that the Board will be reviewing and assessing in determining rates under the Custom IR method. That is made clear in the Board's first sentence describing the Custom IR method. It is the first point of emphasis within each of the other passages reproduced above.

b. Enbridge has provided robust cost forecasts

Considering that the forecasts of costs and revenues lie at the heart of a Custom IR application, it is surprising that intervenors have chosen not to address Enbridge's forecasts in any detail. Instead, intervenors narrowly focus on their contention that Enbridge's forecasts are not legitimate because they are not accompanied by the types of benchmarking evidence that intervenors expect. This is clearly seen in the Final Argument of Energy Probe, where it is stated that:

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[114] RRFE Report, p. 19.
[115] RRFE Report, pp. 19-20.

> "The Board expects that a distributor that applies under this method will file robust evidence of its cost and revenue forecast over a five year horizon...". EGD did not file any external total cost benchmarking evidence and relied solely on internal forecasts to justify its costs. EGD certainly has not filed robust evidence to support its capital expenditures or O&M costs for the fourth and fifth years of the IR term as both are based on the forecasts for the third year of the plan.[116]

The Board Staff Submission includes a similar theme, under the heading “Forecasts”, stating that there is forecast risk unless independent and external benchmarking evidence is provided.[117]

In Enbridge’s view, the appropriate and expected approach under Custom IR is that the evidence filed in relation to forecast costs and revenues will be considered and assessed by the Board, taking into account the applicant’s evidence (including testimony) and interrogatory and undertaking responses. In contrast, the theme of intervenor submissions is that Enbridge’s evidence of its cost and revenue forecasts is not meaningful because it is not supported by third party benchmarking. Enbridge strongly disputes this notion.

Within this proceeding, Enbridge has provided thousands of pages of evidence (including pre-filed evidence, Interrogatory responses, Technical Conference testimony and undertakings and Oral Hearing testimony and undertakings), explaining and justifying its cost and revenue forecasts for the 2014 to 2018 term. There is little, if any, discussion within intervenor submissions setting out how this evidence is flawed or less than robust. Very few questions are raised about the specific costs and revenues that are detailed and justified within the voluminous evidence.[118] If there were significant issues with Enbridge’s evidence, or the particular costs described therein, then one would have expected to see that addressed somewhere in the almost 500 pages of stakeholder submissions. That is not the approach that intervenors have taken. Taking the Company’s Core Capital requirements as an example, Enbridge filed more than 500

[116] Final Argument of Energy Probe, p. 8.
[117] Board Staff Submission, p. 15.
[118] The specific issues that were raised, predominantly in relation to O&M costs and revenue and volumes projections, are addressed later in this Reply Argument.

pages of detailed evidence, answered many interrogatories, provided a panel of witnesses at the Technical Conference, and provided six witness panels at the Oral Hearing, all in support of the required activities and proposed budgets. As far as Enbridge can discern, no party has filed submissions specifically questioning any item within the Core Capital budgets. One conclusion that could be drawn is that parties do not have specific issues with particular items within the cost forecasts.

Within its Final Argument, SEC seeks to cast doubt on the Company's cost forecasts, stating that the Company knows that these are wrong because they exclude certain costs (such as salary increases and "variable costs") that Enbridge knows will be incurred.[119] What SEC fails to mention is that the approach taken by Enbridge is directly in line with the Board's expectations for the Custom IR method. As set out above, the Board expects to set rates based, first and foremost, upon "the distributor's forecasts (revenues and costs, including inflation and productivity)".[120] Therefore, it is only appropriate that Enbridge's forecasts of costs include the challenges that the Company has set for itself to achieve productivity savings within its operations.

IGUA and Energy Probe also take issue with Enbridge's costs forecasts for 2017 and 2018, because they are based upon projections of spending requirements in prior years.[121] Enbridge acknowledges that the cost forecasts for 2017 and 2018 are not based upon detailed budget projections specific to those years. The reasons for the approach that Enbridge has used are explained in evidence.[122] What is important to understand, though, is that the result of Enbridge's approach is that the forecast budgets for 2017 and 2018 are lower than would be the case if they were based on detailed budget projections. This favours ratepayers and adds risk for Enbridge's shareholder. For example, the 2017 and 2018 capital budgets are fixed at 2016 levels, and do not even include any inflation or any other escalation factor. The resulting

[119] Final Argument of SEC, pp. 32-34.
[120] RRFE Report, p. 19.
[121] Final Argument of IGUA, p. 5 and Final Argument of Energy Probe, p. 8.
[122] See, for example, Ex.A2-1-1, pp. 2-3 and 17 and Ex.B2-1-1, pp.39-42.

budget levels are significantly below what is forecast within Enbridge's Asset Plan.[123] In relation to O&M budgets, the rate of change for 2017 and 2018 is equivalent to the prior years of the Customized IR plan term. Enbridge's chosen approach is a fair approximation of where its O&M costs are likely to be during years that are four and five years following the time at which the forecasts were prepared. This approach squarely places inflation risk on the Company, in the event that inflation rates increase over time.

c. Enbridge makes appropriate use of its Asset Plan

Several parties take issue with the Asset Plan that Enbridge has filed in this case, and assert that it does not meet the expectations set out within the RRFE Report and that it is not clearly linked to the filed capital budgets.[124] Enbridge objects to these characterizations. The Company's evidence meets the Board's expectation that an applicant under the Custom IR method "will file robust evidence of its cost and revenue forecasts over a five year horizon, as well as detailed infrastructure investment plans over that same time frame."[125] The evidence that Enbridge has provided is consistent with the Board's expectations that an applicant will demonstrate the "fundamental principles of good asset management and co-ordinated longer-term optimized planning".[126] Moreover, as described below, the Asset Plan was a fundamental input into the Company's capital budget process, and was a key determinant of the capital spending forecasts that have been filed in this case.

Enbridge's 2013 to 2022 Asset Plan[127] is a detailed examination of the Company's current distribution assets, setting out the expected requirements over the next ten years. As explained within the document,

> The purpose of an Asset Plan is to define and communicate the condition of, and what needs to be done with the Company's assets over a specified

[123] Ex.B2-1-1, pp.39-42.
[124] See, for example, Board Staff Submission, pp. 13-14 and Energy Probe Final Argument, p. 8.
[125] RRFE Report, p. 19.
[126] RRFE Report, p. 10.
[127] Ex.B2-10-1.

> period of time, the rationale behind these activities, and the investments needed for execution.[128]

Enbridge's Asset Plan has been prepared in accordance with industry standard asset management practices.[129] Importantly, no party has taken issue with any items that are contained within the Asset Plan. The only criticism in relation to the contents of the Asset Plan is that it does not include the Company's non-distribution assets (storage, facilities, fleet and IT). However, the fact that these classes of assets are not included within the Asset Plan does not mean that that there is no long-term planning or good asset management for these items. To the contrary, as demonstrated within Enbridge's evidence, the Company has long-term strategies and approaches to address requirements in each of these areas. The results of those strategies and approaches can be seen in evidence related to facilities planning[130], fleet management[131] and long-term strategies to manage the safe operation of the Company's storage facilities[132]. It would appear that stakeholders have few concerns with the Company's plans within those areas, as no party asked any questions at all of the witness panel presented to address those items.[133]

While it is true that the Company continues to evolve its asset management discipline, and seeks further improvements[134], that does not imply flaws or failings in the 2013 to 2022 Asset Plan. As Mr. Sanders testified, and as Enbridge's evidence indicates, the filed Asset Plan is the second iteration of the Company's Asset Plan, and it provides key insight into methods of determining risk and how to apply the risk to the Company's existing assets.[135] The fact that Enbridge's asset management practice will continue to evolve signifies the Company's commitment to continuous improvement in ensuring the

[128] B2-10-1, p.5.
[129] B2-10-1, pp.17-18. As explained in testimony, Enbridge has presented its Asset Plan to the Technical Standards and Safety Authority. Ms Lawler indicated her understanding that the TSSA is satisfied with the approach being taken by Enbridge. (5Tr.37)
[130] Ex.B2-9-1, p. 1.
[131] Ex.B2-9-1, p. 2.
[132] Ex.B2-6-1, pp. 1-3.
[133] 6Tr.144-145.
[134] 5Tr.162.
[135] 5Tr.68-69.

safety of its distribution system. To criticize the Company for striving to improve in this regard[136] is entirely unfair.

Similarly, the criticism that "comprehensive asset planning is relatively new to the Company – at least in the form contemplated by the Custom IR planning process under the RRFE"[137] is also unfair. The Company's first Asset Plan was completed before the RRFE Report was issued. To the extent that the Board has evolved its expectations for asset management through the RRFE Report that was issued in October 2012, then it can be said that every utility is "relatively new" to those expectations.

Enbridge's Asset Plan was a fundamental input into the capital budget requirements that are being presented in this case. As explained in evidence, the Asset Plan was the first and largest input into the capital budget process that was undertaken in the first half of 2013 to arrive at the capital budget forecasts that have been filed in this case.[138] The Asset Plan was used to identify the areas in which Enbridge must focus its capital spending in coming years. However, as explained within the Asset Plan itself and in testimony by Mr. Sanders, Enbridge's Asset Plan is not a budget document.[139] While the Asset Plan identifies the risks and requirements associated with the Company's assets, it does not precisely identify all associated costs:

> EGD's Asset Plan is intended to serve as a planning tool to proactively understand requirements for the future, and help forecast and plan work, and related capital expenditures over a 10-year period. It is not intended to represent a detailed 10-year budget.[140]

The fact that the final capital budgets differ from the Asset Plan reflects the fact that after having considered the relevant inputs from the Asset Plan, the Company went through further prioritization and rationalization exercises to finalize the capital spending

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[136] Final Argument of IGUA, p. 5.
[137] Board Staff Submission, p. 14.
[138] B2-1-1, pp. 18 and 20.
[139] 5Tr.74.
[140] Ex.B2-10-1, p. 13.

requirements set out in the evidence (which are inclusive of productivity targets and capital smoothing, and exclusive of "variable costs").[141]

d. Productivity is Embedded in Enbridge's Forecasts

The description of the Custom IR method within the RRFE Report indicates that expected inflation and productivity will be built into the rate adjustment over the IR term.[142] Enbridge's Customized IR application satisfies that requirement.

The Company does note that, in the chart describing the three rate-setting methods under the RRFE, the reference to inflation and productivity refers to "the Board's inflation and productivity analysis". It is Enbridge's understanding that the Board has not provided any "inflation and productivity analysis" that is relevant to gas utilities.[143] Instead, Enbridge has incorporated its own expectations of inflation and productivity into the cost forecasts that it has filed.

As explained at length in prefiled evidence[144], testimony[145] and undertaking responses[146], there is a very significant amount of forecast productivity savings embedded within the proposed Allowed Revenue amounts. As summarized in Undertaking J1.6, the embedded productivity amounts over the Customized IR term represent a reduction of $172 million in O&M, and $162 million in capital. On top of that, Enbridge has not included variable costs of around $264 million within its 2014 to 2018 capital budget and will have to absorb any such costs when they arise. This is discussed further in a later section of this Reply Argument, under the heading "Productivity Adjustment and Stretch Factor". As the Company has indicated, it will be very challenging to find ways to accommodate these embedded productivity amounts.

[141] The capital budget process is set out in detail within Ex. B2-1-1.
[142] RRFE Report, p. 20.
[143] 2Tr.150.
[144] See, for example, Ex.A2-1-2.
[145] See, for example, 1Tr.10 and 13.
[146] See, for example, Ex.J1.6 and Ex.J5.9.

Additionally, as already described in Argument in Chief[147] and this Reply Argument, the productivity-enhancing goals that underlie the SEIM will further incent the Company to achieve sustainable productivity gains during the IR term.

Enbridge disagrees with the suggestion the Company should have provided more tangible plans and proposals in respect of productivity than simply a "baked in" amount.[148] The fact is that an applicant often will not know where and how they will achieve productivity gains during five years of future operations. Indeed, if this was known, it would show up in cost forecasts. The approach of including productivity challenges directly as an offset to budget amounts is very similar to what is accomplished by an "X Factor", in that the utility is committed to a particular productivity challenge, but not to the means of achievement.

The Company's filed cost forecasts take into account the forecasts of inflation that were prepared by Concentric. The Company is not aware of specific inflation forecasts that the Board had prepared as of the filing date of this case which relate to 2014 to 2018.

It is clear, therefore, that the rates to be approved under the Customized IR plan, which reflect the filed Allowed Revenue amounts, meet the Board's expectation that "expected inflation and productivity will be built into the rate adjustment" over the IR term.

e. Benchmarking

Stakeholders place great emphasis on the Board's statement within the description of the Custom IR method that the Board will be informed by benchmarking to assess the reasonableness of distributor forecasts. As noted, stakeholders key on this item, and ignore the fact that the Board's focus in describing Custom IR is on "forecasts" (it is

[147] Argument in Chief, pp. 68-70.
[148] Board Staff Submission, p. 17.

interesting to note that the word "forecast" is used six times in the description of Custom IR, while the word "benchmarking" only appears once[149]).

As explained within the "Benchmarking and External Evidence" section of this Reply Argument, Enbridge has provided appropriate benchmarking evidence, taking into account limitations on what can reasonably be produced, as well as its interpretation of the Custom IR method being based primarily on "forecasts".

However, as described earlier, in an effort to address differences between Enbridge and stakeholders about what benchmarking information is available and appropriate for future use, Enbridge will proceed to work on a benchmarking study that addresses both capital and O&M together. Specifically, Enbridge will carry out benchmarking for 2014 and 2015, and, if it can be done on a timely basis, 2016. Then, during the term of the IR plan, Enbridge will hold a consultative with stakeholders to allow their review of the benchmarking study and to get their feedback. Based on the results of the consultative, Enbridge will develop a benchmarking study that will be filed on rebasing.

f. Reporting

Enbridge's Customized IR plan provides for annual reporting through the ESM process and for additional end-of-term reporting of a number of items.[150] In the next section of this Reply Argument ("Proposed Changes to Components of the Customized IR Plan"), the Company sets out additional reporting that it is prepared to provide, in response to proposals made by stakeholders.

There is one item relevant to the RRFE Report that should be highlighted here. In the description of the Custom IR method, under the subheading "Capital Spending", the Board indicates that:

> Once rates have been approved, the Board will monitor capital spending against the approved plan by requiring distributors to report annually on

[149] RRFE Report, pp. 18-20.
[150] Ex.A2-11-1 and 2.

> actual amounts spent. If actual spending is significantly different from the level reflected in a distributor's plan, the Board will investigate the matter and could, if necessary, terminate the distributor's rate-setting method.[151]

The Company will meet the Board's reporting requirements. Enbridge will provide whatever annual reporting on actual amounts spent that is required by the Board. This may go beyond the reporting that is already included within ESM applications, to identify differences between annual spending and the amounts that were approved and included in Allowed Revenues. This reporting will allow the Board to assess whether the Company's actual spending is consistent with the approved Customized IR plan. The Company acknowledges and understands that if there are significant differences, then the the Board will investigate the matter and could, if necessary, terminate the Customized IR plan.

g. Symmetry with other aspects of Custom IR method

The Company has taken appropriate guidance from the discussion of the Custom IR method within the RRFE Report. A comparison between the Customized IR plan and the Board's summary description of the Custom IR method shows that the Company has not, as alleged[152], made inappropriate selective use of the Custom IR method as guidance towards the creation of the Customized IR plan. The Table below reproduces the Board's Overview of the Custom IR method within the RRFE Report[153], and also includes a column setting out how the Customized IR plan addresses each of the listed items. As indicated within the chart, each of the listed items is addressed within Enbridge's evidence and/or this Reply Argument.

	Custom IR	**Customized IR**
"Going in" Rates	Determined in multi-year application review	Determined in multi-year application review (Ex.A2-1-1)
Form	Custom Index	Annual Allowed Revenue amounts (addressed below)

[151] RRFE Report, p. 20.
[152] See, for example, Final Argument of CCC, p. 11.
[153] RRFE Report, p. 13.

	Custom IR	**Customized IR**
Coverage	Comprehensive (i.e., Capital and OM&A)	Comprehensive (i.e., Capital and OM&A) (Ex.A2-1-1)
Annual Adjustment Mechanism: Inflation, Productivity and Role of Benchmarking	Distributor-specific rate trend for the plan term to be determined by the Board, informed by: (1) the distributor's forecasts (revenue and costs, inflation, productivity); (2) the Board's inflation and productivity analyses; and (3) benchmarking to assess the reasonableness of the distributor's forecasts	Allowed Revenue amounts are to be determined by the Board, informed by (1) the distributor's forecasts (revenue and costs, inflation, productivity); (2) filed inflation and productivity analyses; and (3) benchmarking to assess the reasonableness of the distributor's forecasts (addressed below)
Sharing of Benefits	Case-by-case	ESM (addressed in Section 9 of Reply Argument); SEIM (addressed in Section 3 of Reply Argument)
Term	Minimum term of 5 years.	5 Years (addressed above within this section 8 of Reply Argument)
Incremental Capital Module	N/A	None. The two new variance accounts for 2017 and 2018 are not ICMs (addressed in Section 12 of Reply Argument)
Treatment of Unforeseen Events	The Board's policies in relation to the treatment of unforeseen events, as set out in its July 14, 2008 EB-2007-0673 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, will continue	Enbridge has proposed appropriate Z Factor language (addressed in Section 9 of Reply Argument)
Deferral and Variance	Status quo, plus as needed to track capital spending against plan	Status quo, with a small number of amendments/additions/subtractions (addressed in Section 12 of Reply Argument)
Performance Reporting and Monitoring	A regulatory review may be initiated if a distributor's annual reports show performance outside of the ±300 basis points earnings dead band or if performance erodes to unacceptable levels.	Similar Off-Ramp (addressed in Section 9 of Reply Argument)

The difference between the Custom IR method and the Customized IR plan that is noted within the chart, but not addressed elsewhere in this Reply Argument, relates to the "form" of rates (or distributor-specific rate trend) that is anticipated by the Custom IR method. In the Customized IR plan, Enbridge proposes that Allowed Revenue amounts will be set separately for each year, instead of summing the amounts together and creating a smoothed "rate trend". There are two logical reasons for this approach, as explained in testimony.[154] First, the annual rate changes forecast under Enbridge's Customized IR plan are relatively stable. Between 2014 and 2018, the forecast year-over-year bill increases for residential customers range from around $14 to around $30, depending on the year.[155] This does not suggest the need for a smoothing approach. Second, Enbridge's Customized IR plan includes an asymmetrical ESM, which provides for sharing with ratepayers in the event of over-earning. As Mr. Lister explained in testimony, this does not align well with rate smoothing:

> … trying to smooth rates within the confines or within the parameters of an ESM, an earnings sharing mechanism, very quickly leads to complications.
>
> For example, in rate smoothing, at a very theoretical level, there will be years where you under-recover or over-recover. There is nothing theoretically wrong with that, but when it is assigned to an ESM, an asymmetric ESM in particular, it creates years where you would be sharing when you are over-recovering and not recovering when you are under-recovering. …. it was the addition of the ESM mechanism that complicates rate smoothing.[156]

Given these circumstances, Enbridge believes that it is appropriate for its Customized IR plan to result in Board-approved annual Allowed Revenue amounts, rather than a Board-approved "rate trend".

9. Proposed Changes to Components of the Customized IR Plan

The components of Enbridge's Customized IR Plan were set out in evidence[157] and highlighted in Argument in Chief[158]. The arguments from intervenors address many of

[154] 2Tr.72-75.
[155] Ex.A2-1-1, p. 40.
[156] 2Tr.74.
[157] Within the A2 series of exhibits.
[158] Argument in Chief, pp. 4-8 and 64-73.

these components, and provide proposals for changes to some of them. As described above, Enbridge continues to maintain a constructive attitude towards the development of an appropriate IR methodology, and is open to appropriate changes. This is seen in the following pages, where the Company sets out its response to the various intervenor proposals to change components of the Customized IR plan.

a. Annual Rate Adjustment Process

Enbridge's proposed annual rate adjustment process is very similar to what was in place during the 1st Generation IR term.[159] Given that similarity, and given that it is predominantly items of a "pass-through" nature that will be updated within the rate adjustment process, Enbridge disputes BOMA's characterization[160] of this process being very similar to cost of service.

The only party to offer substantive comments on the rate adjustment process is Energy Probe, who proposes that additional items should be updated each year during the rate adjustment process, rather than being fixed in this proceeding. In particular, Energy Probe proposes that other revenues[161] and customer additions[162] numbers should be updated annually within the rate adjustment proceedings.

Enbridge does not agree that this proposal is appropriate. The Company seeks to maintain the rate adjustment proceedings to be as mechanistic as possible. Increasing the number of items that will be subject to debate makes that more difficult. Moreover, in the case of customer additions, significant portions of the capital budgets have been forecast based upon the customer addition forecast. It would not be consistent, therefore, to change annual customer addition forecasts for volumes purposes without making corresponding adjustments to the capital budget inputs related to the cost of customer additions. Interestingly, the approach advanced by Energy Probe could be

[159] See Ex.A2-3-1.
[160] Submissions of BOMA, p. 24.
[161] Final Argument of Energy Probe, p. 32.
[162] Final Argument of Energy Probe, p. 34.

seen to decrease Enbridge's risk, which is incongruent with Energy Probe's overall view of the Customized IR plan.

b. Cost of Capital

Under the Customized IR plan, Enbridge's cost of capital is forecast for each year of the IR term and included as a cost within Allowed Revenues for each year. The rationale for this, as explained in Argument in Chief[163], is that the Customized IR plan builds up costs for each year (taking into account productivity) in order to set Allowed Revenue amounts. As recognized within the EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities (Cost of Capital Report), return on equity (ROE) is a cost for the utility.[164] Similarly, cost of debt is also a cost to the utility.[165]

One response to Enbridge's position is that cost of capital parameters (ROE and cost of debt) are fixed under an I Minus X type of model, and the same should hold true for Customized IR.[166] It is also argued that the Union Gas Settlement provides for a fixed ROE of 8.93%, and it is fair that the same parameter should apply to Enbridge.[167] Several parties point to the $130 million impact of using forecast ROE within Allowed Revenue each year, rather than holding the 2013 ROE fixed for six years[168], and this is cited as a reason why ROE should be held constant. Enbridge disagrees with these contentions, for several reasons.

First, as noted above, cost of capital is a legitimate cost to Enbridge. Within a model where Allowed Revenue amounts are set on the basis of forecasts of costs (taking into account productivity), it is inconsistent that a key determinant of one significant category of costs (cost of capital parameters) will be left unexamined and unadjusted for five years. That is particularly the case where the only evidence on the record is that this

[163] Argument in Chief, pp. 38-41.
[164] Cost of Capital Report, p. 20: http://www.ontarioenergyboard.ca/OEB/_Documents/EB-2009-0084/CostofCapital_Report_20091211.pdf
[165] Cost of Capital Report, pp. 51 and 56.
[166] See, for example, Final Argument of CCC, p. 18.
[167] See, for example, Written Submissions of APPrO, p. 38 and Final Argument of VECC, pp. 17-18.
[168] See, for example, Board Staff Submission, p. 41 and Final Argument of CCC, p. 18.

determinant (cost of capital parameters) will change each year. No party contends that interest rates or credit spreads, which drive the determination of ROE under the Board's formula and which impact on debt costs, will not change. Enbridge's witnesses spoke to this issue, in the testimony that is reproduced in Final Argument of SEC[169]:

> MR. CASS: Why does Enbridge say that its proposed treatment of the cost of capital under the customized IR model is appropriate?
>
> MR. LISTER: It is our view that the cost of capital as recognized in the fair-return standard is a legitimate utility cost.
>
> Since we are forecasting the utility's costs, a cost that has to be considered is the cost of capital.
>
> And that is our -- why we have chosen to forecast the cost of capital as we have, and that evidence is found at Exhibit A2, tab 5, schedule 1.
>
> MR. FISCHER: If I could just add to Mr. Lister's comments, so cost of capital is a cost like all other costs that a utility must bear. And in terms of the customized IR approach, which is -- has strong analogies to the custom IR method available to electric utilities, you know, it needs to be included as a forecast cost element, to be consistent with that approach.
>
> So that is why it is important that those costs be included in a determination of the revenue cap on a go-forward basis.[170]

As SEC concedes in its submissions, there is "some logic" to Enbridge's position.[171]

Second, the suggestion that the cost of capital under an I Minus X model is fixed or static is misleading. Under an I Minus X approach, the cost of capital (both debt and cost of equity) is part of the overall revenue requirement or rates that are subject to annual formulaic increases through the escalation factor. This was explained in Enbridge's testimony:

> MR. RYCKMAN: But if I could just add to that, for clarity, what Mr. Lister and Mr. Fischer are saying is that to the extent your cost of capital is

[169] Final Argument of SEC, p. 46.
[170] 2Tr.155.
[171] Final Argument of SEC, p. 46.

> part of your allowed revenues and your allowed revenues are being impacted by I-X, there is an increase through that process.
>
> So the reason I raise that is there's some discussion that the ROE was fixed. But the ROE, although it was set at a value at the start, is subject to the escalation of the formula implicitly. I think that is the difference.[172]

Further, the items that the Board has determined can be used to set ROE that approximates a Fair Return (Long Canada Bond values and utility credit spreads) can be discretely forecasted, so that there is no need to rely on an indirect methodology, which assumes that changes in inflation will approximate changes in the cost of capital.

While Enbridge has included the impacts of inflation within its O&M and capital spending forecasts for the Customized IR term, that in no way incorporates or reflects forecast changes in the cost of capital parameters.[173] Cost of capital reflects the cost of debt and equity related to a given level of assets and expenditures. Accordingly, there will be different (incremental) impacts from changes in cost of capital parameters that are independent of changes in O&M and capital spending forecasts.

Third, as already discussed, the efforts to force-fit Enbridge into the parameters of the Union Gas Settlement are misguided. That case represents a negotiated settlement, with a different utility, under different circumstances, and using a different ratemaking model. The Customized IR plan, which draws from Building Blocks models and the Board's Custom IR method, is based on forecasts of costs to be incurred over the next five years. Enbridge's approach is entirely consistent with the first sentence of the Board's description of the Custom IR method in the RRFE Report:

> In the Custom IR method, rates are set based on a five year forecast of a distributor's revenue requirement and sales volumes.[174]

While there is no separate discussion within the RRFE Report of treatment of cost of capital in the Custom IR model[175], Enbridge submits that this is not necessary. From a

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[172] 1Tr.171. See also Ex. J1.11.
[173] In response to Board Staff Submission, p. 42 and Submissions of BOMA, p. 22.
[174] RRFE, p. 18.

ratemaking perspective, the cost of capital is just as much a cost to the utility as is O&M or capital spending, and therefore is a cost that is part of a utility's cost forecasts.

Finally on this point, Enbridge believes that whatever treatment is deemed appropriate for ROE should also apply in relation to cost of debt. If the Board determines that ROE is to be forecast each year, then the same should hold true for cost of debt. Conversely if the Board determines that ROE is to be fixed at 2013 levels, then the same should hold true for cost of debt. With this in mind, the Company notes that the impact of including forecasts of ROE and cost of debt within Allowed Revenue each year (as compared to holding the cost of capital parameters fixed at 2013 levels) is lower from the $130 million cited in intervenor argument. The $130 million amount only relates to changes in ROE, and does not include the impact of changes in the cost of debt. As recognized by SEC[176], the impact of fixing the cost of debt parameters (which are forecast to decline over the IR term) will offset the impact of fixing ROE. The cost of debt is forecast to decline by $51 million over the IR term, as compared to the cost of debt using 2013 values.[177] When this is offset against the $130 million impact of the forecast changes in ROE, the total impact of including forecasts of cost of capital parameters within Allowed Revenue each year (as compared to holding the cost of capital parameters fixed at 2013 levels) is $79 million.[178]

Energy Probe and BOMA object to Enbridge's treatment of the cost of capital, arguing that Enbridge is not entitled to make use of the ROE Formula from the Cost of Capital Report to forecast ROE because this is not a cost of service application.[179] While it is true that the Cost of Capital Report states that the ROE Formula is for use in cost of service applications, some context is important.

First, the Cost of Capital Report states that it is a "policy", and that:

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[175] See Final Argument of Energy Probe, p. 20.
[176] Final Argument of SEC, p. 47.
[177] 10Tr.5-6 and Ex.I.A9.EGDI.SEC.43.
[178] *Ibid*.
[179] Final Argument of Energy Probe, p. 20 and Submissions of BOMA.

> Board panels considering individual rate applications, however, are not bound by the Board's policy, and where justified by specific circumstances, may choose not to apply the policy (or a part of the policy).[180]

Clearly, the Board can depart from rigid interpretation of the policy within the Cost of Capital Report in appropriate circumstances.

Second, it is important to understand why the Board stated that the ROE Formula was only to be used within "cost of service applications". This was to ensure that updates to ROE would only be made in the context of a comprehensive case, where all of a utility's costs were being examined. That point is made clear in a subsequent decision of the Board relating to Hydro One, where the Board provided commentary with respect to implementation of the Board's revised ROE Formula from the Cost of Capital Report:

> It is the Board's view that it is amply clear in the Board's report that the revised methodology is intended to be implemented in the context of a cost of service application. On page 61 of the report of the Board states:
>
> The policy set out in Chapter 4 of this report will come into effect for the setting of rates, beginning in 2010, by way of a cost of service application.
>
> In this case, the 2010 cost of service application was, with the sole exception of the consideration of the four proposed construction projects mentioned above, decided fully six months before the Board's cost of capital report was issued. There is therefore no cost of service application to provide a context for the appropriate consideration of the revised cost of capital methodology. <u>The implementation of that methodology is dependent on its consideration within a cost of service application which allows for a full and contemporaneous consideration of all the company's costs in setting just and reasonable rates. In this case that is not possible</u>, unless the applicant decides to file a new cost of service application for 2010 rates. In the course of his remarks, counsel for Hydro One indicated that such an application was not being contemplated by his client.[181]
>
> (Emphasis added.)

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[180] RRFE Report, p. 13.
[181] Decision and Order of the OEB in the Matter of Hydro One Networks Inc., EB-2010-0003, dated April 5, 2010:http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/185455/view/dec_order_HONI_20100405.PDF

Of course, in the current case, the Board does have the opportunity to review all of Enbridge's costs for the Customized IR term, in the process of setting just and reasonable rates. Therefore, even though this is not a "cost of service" case, the circumstances are appropriate for the application of the ROE Formula from the Cost of Capital Report.

Third, at the time that the Cost of Capital Report was completed, the RRFE Report and its Custom IR method did not yet exist. Therefore, the question of how the ROE Formula would apply under the Custom IR method (or a similar approach) was not contemplated within the Cost of Capital Report. In Enbridge's view, it is entirely appropriate that the Board's ROE Formula would be used to determine the relevant portions of a utility's forecast cost of capital in a model that is premised upon a five year forecast of a distributor's revenue requirement and sales volumes.[182]

In all of these circumstances, Enbridge submits that its use of the Board's ROE Formula to forecast ROE for each year of the Customized IR term is appropriate.

As noted, Enbridge has provided forecasts of ROE and the cost of debt for each year of the Customized IR plan term, based on current information as of the time when the Company filed its Application.[183] Several parties have indicated concern with the accuracy of the forecasts, stating that interest rate projections are "notoriously inaccurate"[184]. As stated in evidence, before filing the case the Company considered an approach whereby ROE and cost of debt parameters would be re-set each year within the annual rate adjustment proceedings, but decided against that approach in order to minimize the number of annual adjustments.[185] Now, having considered the stakeholder submissions, Enbridge is prepared to adopt a different approach to cost of capital, whereby ROE and the cost of debt parameters would be set for each year during the relevant rate adjustment proceeding. Indeed, Enbridge has already indicated

[182] RRFE Report, p. 18.
[183] See evidence filed at Exhibit E.
[184] Board Staff Submission, p. 41; see also Final Argument of SEC, p. 47.
[185] Ex.A2-5-1, p. 3.

its openness to such an approach within its testimony.[186] Should the Board agree this approach is appropriate, then the cost of capital within Allowed Revenue for 2014 would be set on a final basis in this proceeding. The cost of capital within Allowed Revenue amounts for 2015 to 2018 would be set on a placeholder basis in this proceeding, and set on a final basis in the relevant rate adjustment proceeding. The inputs to be used to determine ROE and cost of debt parameters each year under that approach would be the most up-to-date data available to be incorporated within the next year's rates. If timing permits, the ROE to be used would be the Board-approved amount, which is currently prepared in October and publicized in November of each year.

c. Off-Ramp

Enbridge proposes the inclusion of a symmetrical Off-Ramp in circumstances where weather-normalized earnings are more than 300 basis points different from the ROE determined annually through the application of the Board's ROE Formula.[187] Both BOMA[188] and CCC[189] support this proposal.

Energy Probe questions whether an Off-Ramp is required, and also submits that it should only be applicable the second year that the utility under-earns more than 300 basis points.[190] Enbridge does not agree. The Off-Ramp does not amount to an automatic termination of the Customized IR plan. Instead, as explained in evidence, the Off-Ramp requires Enbridge (in the event of significant over- or under-earning) to make application to the Board for a review of the Customized IR plan.[191] On such application parties may take any position that they wish, meaning that Energy Probe will be free to submit at that time that Enbridge should live with the Customized IR plan for additional time, and seek to reverse the under-earnings.

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186 2Tr.71. Mr. Lister indicated that Enbridge is prepared to re-set ROE each year, using the Board-approved level for electric utilities, and that cost of debt would be set at the same time based upon then-current inputs.
187 Ex.A2-6-1.
188 Submissions of BOMA, p. 30.
189 Final Argument of CCC, p. 16.
190 Final Argument of Energy Probe, pp. 16-17.
191 Ex.A2-6-1.

Energy Probe also proposes that the ROE to be used as the point of comparison for the Off-Ramp should be the same ROE that has been used for ratemaking purposes in the relevant year.[192] Enbridge accepts that proposal.

d. Z Factors

Enbridge's evidence[193] and Argument in Chief[194] set out the reasons why the Z Factor wording from the 1st Generation IR term was very difficult to interpret, and unduly narrow. In response, the Company has proposed updated wording for Z Factors, as follows:

> A Z-factor is a non-routine adjustment intended to safeguard customers and the gas utility against unexpected cost increases or cost decreases that are outside of management control. A cost increase or decreases will be treated as a Z factor if it meets all four of the following criteria:
>
> (i) Causation: The cost increase or decrease, or a significant portion of it, must be demonstrably linked to an unexpected, non-routine cause.
>
> (ii) Materiality: The cost at issue must be an increase or decrease from amounts included within the Allowed Revenue amounts upon which rates were derived. The cost increase or decrease must meet a materiality threshold, in that its effect on the gas utility's revenue requirement in a fiscal year must be equal to or greater than $1.5 million.
>
> (iii) Management Control: The cause of the cost increase or decrease must be: (a) not reasonably within the control of utility management; and (b) a cause that utility management is unable to prevent by the exercise of due diligence.
>
> (iv) Prudence: The cost subject to an increase or decrease must have been prudently incurred.
>
> The criteria described above are the only criteria, implicit or explicit, for Z factor treatment.[195]

[192] Final Argument of Energy Probe, p. 17.
[193] Ex.A2-4-1.
[194] Argument in Chief, pp. 64-67.
[195] Ex.A2-4-1, pp. 1-2; explained at 1Tr.51-59.

Many parties have commented upon Enbridge's proposal. The Company strongly disagrees with the suggestion that the proposed changes will inappropriately increase the opportunities to seek Z Factor relief.[196] The Company does not intend to alter the risk allocation that existed during the 1st Generation IR term.[197] The intent is to make the identification and evaluation of potential Z Factor requests more clear and consistent.[198] This meets the Board's expectation that Z Factors will be applied in "limited, well-defined, and well-justified cases".[199]

There is a wide range of Z Factor proposals from intervenors, ranging from retaining Enbridge's 1st Generation IR wording[200] to making changes to Enbridge's current proposal[201] to adopting the wording from the Union Gas Settlement[202].

For the reasons already set out in evidence and Argument in Chief, Enbridge submits that its Z Factor proposal is reasonable and appropriate. Among other things, it is more appropriate to relate Z Factors to "causes", rather than "events". This is appropriate, as it takes the focus of review away from linking a singular event to all the costs at issue, when there may be a combination of related events all linked to one cause.[203] Sometimes there is no "bright line" to identify a singular cause leading to unforeseen and uncontrollable costs.[204] Sometimes it is difficult to identify something as an "event", such as is the case where a public policy evolves.[205] It is still necessary, though, to demonstrate that causes that lead to cost increases or decreases are unexpected, non-routine and outside of management control. Under Enbridge's proposed updated wording, a Z Factor request will only succeed where it is shown that: (i) the costs at issue are driven by a cause that is unexpected and non-routine; (ii) the costs at issue

[196] See, for example, Submissions of BOMA, p. 30.
[197] 2Tr.78-79.
[198] Ex.A2-4-1, p 1.
[199] Ex.A2-4-1, p.2, quoting from NGF Report, pp. 4 and 30.
[200] See, for example, Submissions of BOMA, p. 25.
[201] See, for example, Board Staff Submission, pp. 38-40.
[202] See, for example, Final Argument of CCC, p. 16.
[203] See discussion at Ex.I.A10.EGDI.SEC.45.
[204] 1Tr.53-54.
[205] Dr. Kaufmann agrees that a Z Factor should cover changes in public policies that have a material impact on the Company's costs (4Tr.147).

are outside of Allowed Revenue amounts, and meet a materiality threshold of $1.5 million in revenue requirement; (iii) the cause of the cost increase or decrease is not reasonably within the control of utility management and is not a cause that utility management could prevent by the exercise of due diligence.[206] These criteria will be difficult to satisfy, and will not open the floodgates to large numbers of Z Factor requests.

In the event, however, that the Board does not adopt the Company's proposal, then Enbridge submits that the proposed approach by Board Staff is the most appropriate of the intervenor positions.

Board Staff[207], supported by VECC[208] and CME[209], accepts that there is merit in reviewing Enbridge's proposed language with a view to improving the mechanism from what existed in Enbridge's 1st Generation IR term. The main changes proposed by Board Staff are that: (i) within the "Causation" section, the word "cause" be replaced by "event"; and (ii) the "Management Control" section be re-worded to state: "the cost must be beyond what Company management could reasonably control or prevent through the exercise of due diligence". Enbridge agrees that the use of its Z Factor language, inclusive of these changes, is an improvement on the 1st Generation plan Z Factor.

The Company does not agree that it is appropriate to import either the wording or the $4 million materiality threshold for Z Factors from the Union Gas Settlement. As with other provisions of the Union Gas Settlement, the Z Factor provision was the subject of an overall package and should not be considered to have precedential value for other distributors.[210] There has been no evidence within this case to discuss how the Union Gas Z Factor wording would apply to and impact upon Enbridge. Similarly, there has been no evidence in this case around why a $4 million Z Factor threshold should be imposed. There is no significant change in circumstances from Enbridge's 1st

[206] Ex.A2-4-1. paras. 14-24.
[207] Board Staff Submission, pp. 38-40.
[208] Argument of CME, p. 23.
[209] Final Argument of VECC, p. 27.
[210] 1Tr.99-100.

Generation IR term, when a $1.5 million threshold was considered appropriate.[211] As it stands, that threshold is already 50% higher than the maximum Z Factor threshold for electricity distributors, including Hydro One and Toronto Hydro.[212]

Finally, Enbridge does not agree with the proposal from Energy Probe[213] and SEC[214] that Z Factor relief would become unavailable when there is over-earning. Imposing that additional requirement would make the Enbridge Z Factor criteria even more stringent than the Union Gas Z Factor wording that those parties advocate. Effectively, this approach would take away the incentive and reward to the Company for achieving productivity gains.

e. ESM

The form of ESM that Enbridge has proposed is the same as in the 1st Generation IR plan, such that normalized earnings more than 100 basis points above the amount determined using the Board's ROE formula will be shared 50/50 with ratepayers.[215]

No party disputes that it is appropriate for Enbridge's IR plan to include an ESM.

Questions were raised within a number of submissions about whether the ROE to be used for the determination of the "pivot point" (base ROE)[216] for ESM calculations should be fixed at this time, or re-set annually.[217] Enbridge believes that it is most appropriate to continue the ESM approach from its 1st Generation IR plan, which provided for the ROE used for ESM purposes to be updated each year.[218] This allows for earnings to be measured against the ROE that would apply using the Board's ROE Formula in the subject year. Assuming that the Board adopts the Company's updated

[211] See discussion at Ex.I.A10.EGDI.EP.6.
[212] See s.3.2.2.3 of Filing Requirements for Electricity Distribution Rate Applications: http://www.ontarioenergyboard.ca/oeb/_Documents/Regulatory/Filing_Reqs_Dx_Applications_ch_1.2.3.5_20130717.pdf
[213] Final Argument of Energy Probe, p. 16.
[214] Final Argument of SEC, p. 60.
[215] Ex.A2-7-1.
[216] To use the phrasing within the Final Argument of Energy Probe, p. 19.
[217] See, for example, Final Argument of CCC, p.17 and Final Argument of Energy Probe, p. 19.
[218] Ex.A2-7-1, pp. 2-3.

Cost of Capital proposal to set the ROE for ratesetting purposes each year within the rate adjustment proceeding, then the same ROE will be used for ratesetting and ROE purposes each year.

Beyond the ROE calculation question described above, some parties support[219], or do not oppose[220], the parameters of Enbridge's proposed ESM. Other parties have suggested changes to the sharing approach. While the approaches suggested by different intervenors vary, the common theme is that sharing of over-earning should be weighted more strongly in favour of ratepayers.[221] The main justification for that position seems to be that it would be a safeguard to ratepayers against Enbridge having used the Customized IR plan to overforecast costs and underforecast revenues, which stakeholders say is difficult to assess without "independent third party benchmarking".[222]

Enbridge disagrees with the intervenor position on benchmarking, for reasons already stated, and also submits that the evidence does not support any conclusion that there is overforecasting in Enbridge's Allowed Revenue amounts. To the contrary, the Company believes that it will be challenging to operate at the applied-for levels. That being said, Enbridge acknowledges that from a ratepayer perspective, an ESM can mitigate the risks to and impacts upon ratepayers from spending that is different from forecast. As explained by LEI in their evidence:

> The application of an ESM complements the incentives built into the plan, providing an incentive for a utility to improve its efficiency but also to allow customers to share in the benefits, and furthermore safeguard consumers if there is actual under-spending of allocated capital investment in the allowed revenue amounts during the term of the plan.[223]

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[219] Submissions of BOMA, p. 30.
[220] Board Staff Submission, p. 55.
[221] See, for example, Final Argument of CCC (p.17), which proposes 50/50 sharing of all over-earning, and the Final Argument of Energy Probe (pp. 18-19), which proposes that the first 100 basis points of over-earning go to ratepayers, then the next 100 basis points of over-earning would go to Enbridge and any further overearning beyond 200 basis points would be shared 90/10 in favour of ratepayers.
[222] Final Argument of Energy Probe, p. 18.
[223] Ex.A2-10-1, p. 14

LEI provided further comment on this topic, in response to the PEG evidence. In particular, LEI stated that:

> EGD's proposed ESM is both an implicit and an explicit safeguard to consumers. If the cost forecasts are not reasonable and EGD has over-inflated them, then EGD's actual ROE in future years will exceed the allowed ROE. In such a case, sharing of benefits may be triggered under the ESM and customers will get a share of the savings for any under-spending relative to the forecast in any given year. Given the ESM may be triggered if capital spending is lower than forecast, there is also implicit pressure on EGD, arising as a result of the existence of the ESM, to ensure that the forecasts it is providing are accurate.[224]

Of course, changing the parameters of an already asymmetrical ESM further in favour of ratepayers has to be balanced against the fact that an IR plan is meant to incent a utility to find and implement sustainable efficiencies. If an ESM is created in a manner that gives a utility little opportunity to benefit from the efforts associated with finding and implementing sustainable efficiencies, then the IR plan will not be successful. PEG speaks to this perspective within its report, noting that redesigning the ESM to provide substantially more reward to ratepayers would significantly undermine the utility's incentive to behave efficiently.[225]

Enbridge strongly believes that it is important to maintain the utility's incentive to find and take advantage of efficiency savings, and that this will not be accomplished if the first amount of over-earning (superior performance) is allocated to ratepayers. On the other hand, the Company strongly believes that its forecasts in this case are reasonable, and that it will be challenged to operate within those forecasts. In order to demonstrate the Company's confidence that it will not inordinately benefit from the Customized IR plan, Enbridge would be prepared to adopt an amended form of ESM, that provides for much greater sharing of over-earning with ratepayers within the Customized IR plan. Enbridge's proposed approach would still allow the Company to retain the first 100 basis points of overearnings, but then it would share any

[224] Ex.I.A1.EGDI.CME.1, Attachment 2, p. 8.
[225] Ex.L-1-2, p. 20. This premise was agreed upon by all three experts (Mr. Coyne, Ms Frayer and Dr. Kaufmann) in testimony at 4Tr.91-93 and 95-96.

overearnings beyond that level on a 90/10 basis in favour of ratepayers. The determination of net earnings would continue to be calculated in the manner set out in evidence.[226]

This approach would maintain the Company's incentive to improve its efficiency, but it would also provide for greater safeguards to stakeholders around the level of forecast costs that are included within Allowed Revenue amounts. It should be emphasized, though, that this amended approach to ESM is particular to the Customized IR method, which includes cost forecasts. The Company does not believe that such an amended approach is compatible or appropriate for use with IR plans that are not premised on a Custom IR method or Building Blocks approach.

f. SEIM

This subject is discussed above, under the heading "IR Should be Aimed At Sustainable Efficiencies, Not Arbitrary Cost-Cutting".

g. Performance Measurement

Apart from discussion in relation to the SEIM, the topic of performance measurement received very little attention within intervenor submissions. No party had any criticism or comment in relation to the Company's proposed Performance Measurement Framework, which is described in evidence[227] and which was included within Issue 10(e).

Two parties indicated that it is important that Enbridge maintain the current Service Quality Requirements (SQRs) and level of SQR performance throughout the coming IR term.[228] As described within the evidence, Enbridge places priority on meeting and exceeding the SQR expectations and improving its performance in areas where that can be accomplished.[229] Enbridge agrees, as set out below within the Annual Reporting

[226] Ex.A2-7-1.
[227] Exhibit A2-11-2.
[228] Final Argument of CCC, p. 18 and Final Argument of Energy Probe, pp. 11 and 21.
[229] See discussion of the Company's efforts to meet and exceed each SQR, described in Ex.A2-6-1.

section, that it will annually report upon SQR performance, as part of the ESM proceedings.

While Enbridge did point to the fact that the expectations within one of the SQRs are very difficult to reach, and may not be appropriate, the Company has made no request within this proceeding to change that SQR.[230] There is no such issue on the Issues List. Indeed, such a change would require an amendment to the Gas Distribution Access Rule (GDAR), which applies to all gas distributors.

Energy Probe proposes that there should be a penalty imposed on Enbridge if any of the SQRs fall below the 2013 level during the IR term. Under that proposal, penalties would start at $100,000 for one SQR result below the prior year's result, and then increase to $250,000 and double thereafter for each additional failure to meet either the prior year's SQR performance.[231] Energy Probe does not provide any justification for the very significant level of proposed penalties.

The Company objects to Energy Probe's proposal. In virtually every case, Enbridge exceeds the service level mandated by the Board's SQRs.[232] The issue of penalties (or rewards for that matter) related to SQRs during the IR term was not explored in any fashion during this proceeding. Enbridge is not aware that there is any concern that it has, or will, degrade service during an IR term or at any other time. The very substantial penalties proposed by Energy Probe address a problem that does not exist, and that is not expected.

In any event, it is always open to the Board to take appropriate steps if concerns arise that Enbridge's performance is not acceptable. In that regard, it should be noted that SQRs are part of a Board Rule (the GDAR), meaning that it is open to the Board to impose sanctions if a gas distributor fails to meet expectations.

[230] Enbridge does not agree with Energy Probe's characterization of this item, found at page 11 of the Final Argument of Energy Probe.
[231] Final Argument of Energy Probe, p. 11.
[232] See chart set out at page 1 of Ex.A2-11-1.

h. Annual Stakeholder Meeting

Several parties propose that Enbridge should be required to hold annual stakeholder meetings during the IR term, along the lines of what Union Gas agreed to within their Settlement Agreement.[233]

Enbridge agrees to this proposal, because it aligns with the Company's efforts to consult and communicate with its stakeholders. Enbridge acknowledges that annual meetings can serve to increase transparency. Set out below is the manner in which the Company would adapt the Union Gas Settlement provision (section 12.2) to Enbridge's circumstances[234]:

> Enbridge will hold an annual, funded stakeholder meeting (including funding for reasonable preparation for the meeting and follow up comments from the meeting), after the public release of year-end financial results but prior to Enbridge filing its annual non-commodity deferral accounts disposition application (March/April timeframe). At the stakeholder meeting Enbridge will:
>
> 1. Review previous year's financial results (i.e. earnings, capital spending) and other key operating parameters (i.e. SQR performance) for the most recently completed year;
>
> 2. Present and explain market conditions and expected changes/trends, and the impact these may have on the regulated operations;
>
> 3. Present and review the current gas supply plan memorandum[235]; and
>
> 4. Present results of any customer surveys undertaken during the year.
>
> Enbridge will file all information resulting from this annual meeting with the Board and ensure it is available to any party not able to attend.

[233] See, for example, Board Staff Submission, p. 70 and Argument of CME, p. 23.
[234] Note that Item 4 from the Union Gas Annual Stakeholder Meeting, which relates to new capital projects in the coming year that meet the capital pass-through criteria for Y-Factor treatment, is not applicable within Enbridge's Customized IR Plan.
[235] The contents of the Gas Supply Memorandum, as described below under the subheading "Gas Supply Reporting", are consistent with the contents of the similar document that Union Gas is annually preparing and providing to stakeholders.

i. Annual Reporting

Through the annual stakeholder meetings and ESM cases, the Board and ratepayers will be provided with detailed information about the Company's expenditures and results. This will allow all parties to have a strong understanding of the Company's ongoing operations and to evaluate how spending and activities are consistent with what is being approved in this proceeding.

Within their submissions, several parties indicate that Enbridge should be required to annually file and provide intervenors with the same information as Union Gas agreed to provide, in section 12.1 of the Union Gas Settlement.[236]

Enbridge has already addressed this within an undertaking response, and has indicated that it will be providing all the same information as Union Gas as part of annual ESM proceedings, or at the end of the IR term, except for those items that are not relevant to Enbridge (such as audited statements for utility operations, which is not something that has been prepared for Enbridge).[237]

Some parties also propose that Enbridge should annually provide intervenors with its RRR filings, which is something that Union Gas has committed to provide each year.[238]

Enbridge is prepared to annually provide intervenors with its RRR filings that are relevant to the regulated utility. This includes such items as SQRs and affiliate transaction reporting. To the extent that aspects of RRR filings relate to unregulated businesses, then only information relevant to the regulated utility will be provided.

In addition, as described in the previous section of this Reply Argument, the Company will meet the Board's reporting requirements on capital spending as set out in the RRFE Report. Enbridge will provide whatever annual reporting on actual amounts spent that is required by the Board. This may go beyond the reporting that is already included

[236] See, for example, Argument of CME, p. 23.
[237] Ex.J1.7.
[238] See, for example, Final Argument of CCC, p. 21.

within ESM applications, to identify differences between annual spending and the amounts that were approved and included in Allowed Revenues. This reporting will allow the Board to assess whether the Company's actual spending is consistent with the approved Customized IR plan. The Company acknowledges and understands that if there are significant differences, then the the Board will investigate the matter and could, if necessary, terminate the Customized IR plan.

j. Productivity Adjustment and Stretch Factor

The Board Staff Submission indicates that if the Customized IR plan is approved, then the Board should impose an adjustment amount representing productivity on Enbridge.[239] Board Staff indicates that the amount should be $20 million per year (a total of $100 million), in addition to the embedded productivity saving that Enbridge has already identified.[240] Further, Board Staff proposes that a "stretch factor" of 0.6% be imposed on Enbridge, which is equal to the highest stretch factor which applies to Ontario's electricity distributors under their 4th Generation IR mechanism.[241]

The approach proposed by Board Staff is unreasonable, and effectively punitive. Enbridge has already provided for a built-in productivity challenge and stretch with the very significant level of embedded productivity savings contained within the Allowed Revenue amounts. The effect of those embedded savings, which are credited to ratepayers even though Enbridge concedes that they may not all be achievable, is to significantly reduce Allowed Revenue amounts. As described in evidence and testimony, and summarized in Undertaking J1.6, the embedded productivity amounts over the Customized IR term represent a reduction of $172 million in O&M, and $162 million in capital. On top of that, Enbridge has not included variable costs of around $264 million within its 2014 to 2018 capital budget and will have to absorb any such costs when they arise. The effect is that:

[239] Board Staff Submission, p. 75.
[240] Board Staff Submission, pp. 75-76.
[241] Board Staff Submission, pp. 77-78.

- Enbridge's Other O&M budgets are around 14% lower than would be the case if no productivity savings were embedded and all expected costs were included;[242] and

- Enbridge's Core Capital budgets are around 13% lower than would be the case if no productivity savings were embedded and all expected costs (including a conservative estimate of 50% of the excluded variable costs) were included.[243]

These are very substantial and real productivity challenges already included within Allowed Revenue amounts. The suggestion that the productivity adjustment should be equal to $20 million per year gives no credit at all for the embedded productivity already committed. To impose a further productivity adjustment is not reasonable or appropriate. As already stated, the revenue requirement reductions suggested by Board Staff in final argument are troubling because they were not tested at all during the evidentiary phase of the proceeding so as to bring out for the Board even a bare minimum of evidence addressing whether or not the cost forecasts resulting from such reductions would be reasonable.

A key part of Board Staff's rationale for a productivity adjustment is that Enbridge had overearnings in the 1st Generation IR term and therefore adjustments should be made going forward for having performed well in the past.[244] This completely discounts the fundamental goal of IR, which is to find efficiencies beyond what is embedded in an IR plan. The Company performed well during its 1st Generation IR term, and rate increases for customers were modest (less than inflation). Throughout the 1st Generation IR term, Enbridge shared the benefits of the efficiencies and savings that it had achieved with ratepayers through the ESM. Enbridge's cost forecasts for future

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[242] The total Other O&M budgets for 2014 to 2018 are $1,205 million (see Argument in Chief, p. 44); the embedded O&M productivity savings of $172 million represents 14.3% of that amount.
[243] The total Core Capital budgets for 2014 to 2018 are $2,286 million (see Argument in Chief, p. 22); the embedded capital budget productivity savings of $162.6 million, plus 50% of the excluded variable costs (which total $264 million) represents 12.9% of that amount.
[244] Board Staff Submission, p. 75.

years take account of efficiencies already achieved during its 1st Generation IR term. The approach advocated by Board Staff does not encourage continued efforts to be efficient. Instead, it is effectively a penalty for prior success. That is not appropriate, and would be a counterproductive message to send to utilities, saying effectively that if there is superior performance in one IR term the benefits of that performance will be clawed back in the next IR term.

The fact that Enbridge has set a goal for itself of exceeding the Board-approved ROE level within its Strategic Plan and Board of Directors Memorandum should not be taken as an indication that the Allowed Revenue amounts presented need to be adjusted because they are unreliable or overstated. Instead, these goals simply indicate that the Company is intent on performing as well as possible – something that is consistent with the Board's goals for a utility under incentive regulation. It is instructive to note that the goals set for itself by the Company within its confidential internal documents for itself are quite modest (around $10-12 million per year)[245], and are significantly lower than the adjustments that Board Staff proposes ($20 million per year plus a stretch factor said to equal a further $7 million per year).

Finally, in relation to the proposal that a stretch factor should be added, in addition to the proposed productivity adjustment, Enbridge has two responses.

First, and most fundamentally, it is not necessary to include both an ESM and a stretch factor within an IR plan. For electricity utilities in Ontario, there has been a stretch factor, but no ESM; for Ontario gas utilities, there has (historically) been an ESM but no stretch factor The OEB has stated in its "Report of the Board: Rate Setting Parameters and Benchmarking under the [RRFE]" that,

> It is important to note that stretch factors are consumer benefits. They are somewhat analogous to earnings sharing mechanisms, although stretch

[245] The Company calculates 60 basis points of overearning (the aspirational goal within the Board of Directors memo at Ex.I.A1.CCC.2, Attachment 1) to equate to around $12 million. That is similar to the annual amount reflected in the Strategic Plan for 2014 to 2018 (on the assumption that the 2018 level would be the same as 2017) – see Ex.J1.4, p.12.

> factors take effect immediately with the application of the formula and are not dependent on the realization of any productivity gains or excess earnings, as would be the case with an earnings sharing mechanism. Stretch factors are an integral part of the IR formula, and are not dependent on future performance by the distributor.[246]

As seen in the Board's comments, it is duplicative to include both a stretch factor and an ESM within an IR plan.

Concentric spoke to this issue within its report, stating:

> While the Ontario electric utilities have performance-based stretch factors, the justification for the stretch factors was in part due to preference of a stretch factor over an earnings sharing mechanism. In the 3rd Generation IR for electric distributors, the Board observed that "[stretch factors] are somewhat analogous to earnings sharing mechanisms." However, because EGD is proposing an earnings sharing mechanism, if EGD is able to produce additional productivity growth, the additional earnings beyond the dead band will be shared with customers. Therefore, a stretch factor is not necessary because EGD's proposed ESM achieves customer benefits that might otherwise be achieved with a stretch factor, with additional opportunity for greater customer benefits.[247]

Enbridge submits, therefore, that a stretch factor is inappropriate in an IR model that already includes an asymmetrical ESM that allows ratepayers to share the benefits of a utility's superior financial performance. In that regard, Enbridge notes that the description of the "Custom IR" method within the RRFE Report indicates that "Sharing of Benefits" for that method is to be determined on a case-by-case basis, and no stretch factor is mandated.[248] This is significant, because stretch factors are mandated for the other two ratemaking methods listed (4th Generation IR and Annual IR index), and also because the wording used makes clear that the Board views stretch factors as being connected to "Sharing of Benefits" which is something that is accomplished by an ESM.

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[246] EB-2010-0379, Report of the Board, Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors, p. 19: http://www.ontarioenergyboard.ca/oeb/_Documents/EB-2010-0379/EB-2010-0379_Report_of_the_Board_20131121.pdf

[247] Ex.A2-9-1, p .45. Concentric further discussed the inappropriateness of a stretch factor for Enbridge within the Customized IR plan at Ex.I.A1.EGDI.CME.1, Attachment 1, pp. 17-18.

[248] RRFE Report, p. 13.

As Enbridge explained in testimony, both the ESM and the SEIM within the Customized IR plan are intended to address the "Sharing of Benefits" requirement.[249]

Second, it is not at all clear to Enbridge why it should be subject to the highest stretch factor that applies to any of Ontario's electricity utilities. As explained within Board Staff's submissions, the highest stretch factor (0.6%) is reserved for utilities whose actual costs are 25% or more above predicted costs.[250] There is no evidence that Enbridge's forecast costs are at all out of line with its peers. The benchmarking evidence submitted in this case demonstrates that Enbridge has been a very strong performer in its O&M costs[251], which is a very significant driver of annual Allowed Revenue amounts. On an overall productivity basis, the only evidence in this case is from Concentric, who undertook a Total Factor Productivity analysis and concluded that Enbridge has outperformed the relevant comparable industry group over the most recent period evaluated.[252]

Finally, it should be noted that the cumulative impact of the Board Staff proposals to amend aspects of the Customized IR plan are much more substantial than indicated in the Board Staff Submission. In their Submission, Board Staff indicate that the impact of their proposals total $489.5 million, and this is around 3.6% of requested revenues over the IR term.[253] However, that approach fails to acknowledge that more than half of Enbridge's "requested revenues" relate to gas costs, which are a pass-through item. When one looks instead at what has been referred to as the "Distribution Revenue Requirement"[254], the impact of Board Staff's proposal is a reduction of around 8.5%.[255]

[249] 2Tr.151.
[250] Board Staff Submission, pp. 77-78.
[251] Ex.A2-9-1, pp. 26-30.
[252] Ex.A2-9-1, pp. 33-35.
[253] Board Staff Submission, pp. 79-80.
[254] The total "Distribution Revenue Requirement" for 2014 to 2018 is approximately $5.75 billion. This is calculated by summing together the annual Allowed Revenue amounts for each year (Ex.F1-2-1, pp.1-5, line 22) and subtracting the gas costs for each year (Ex.F1-2-1, pp.1-5, line 4)
[255] This is derived by comparing the total impact of the Board Staff proposal ($489.5 million) to the "Distribution Revenue Requirement" for 2014 to 2018 ($5.75 billion).

The Company submits that the size of that proposed adjustment underlines that the approach advocated by Board Staff would be penal and inappropriate.

10. Response to Arguments about Customized IR Plan Inputs

In this segment of Enbridge's Reply Argument, the Company will address the various arguments made against the inputs which are part of its Customized IR proposal. These include arguments which relate to forecast capital and O&M expenditures, some of which, like RCAM and Municipal Taxes, are specifically dealt with under their own separate subheading. This segment of the Reply Argument will also respond to the several suggestions that the 2014 base year figures should be adjusted because of opinions expressed about certain forecasts, such as Customer Additions, Volumes, Other Revenues, and the 2013 Revenue Sufficiency.

a. General Observations

In this first Customized or Custom IR proceeding, Enbridge has endeavoured to provide for the Board's consideration a detailed and extensive evidentiary base supporting the inputs into the Customized IR plan. Enbridge filed substantial written evidence detailing its proposed capital spending programs. It also provided in significant detail evidence about the Company's O&M expenses. It produced for cross-examination by intervenors the actual managers of the capital programs and the managers of key O&M departments.

The Company has also filed evidence about its historic capital and O&M expenditures, including Actuals in 2013, and it has responded to numerous written and oral questions about such expenditures. Its witnesses were made available to answer questions under cross-examination in respect of 2013 actual spending and the forecasts and plans for 2014 to 2018. The Board has, therefore, heard directly from those persons personally responsible for the management and operation of significant programs and departments. It has heard directly about the manner in which program and department budgets were set, the importance of the various programs and planned operational activities, and the drivers for changes in scope and costs which have been identified. Accordingly, Enbridge submits that the Board has received the best evidence to support the Application.

Surprisingly, despite the detail and extent of the evidence filed, intervenors did not in their submissions attack the Company's planned capital programs or proposed O&M activities and expenses with any degree of specificity. All of the criticisms were at the aggregate level, virtually without any questioning or concern expressed about individual program and operational activities. The uncontradicted evidence, therefore, is that these activities and programs are needed and are not more complex or larger than what is required for the Company to continue to operate safely and efficiently in future.

It is acknowledged that the onus is on an applicant to justify what is proposed in an application. In this proceeding, the Company has gone to great lengths to set out in detail precisely why certain programs and activities are needed, the credibility of the cost estimates for the programs and the variability, if any, of its cost estimates to historical results. The fact that the onus is on the Applicant does not in any way diminish the ability, indeed the obligation, on intervenors, to challenge the Company's evidence at the level at which it was adduced and to retain appropriate consultants or experts to assist in the questioning of the evidence. This simply did not occur. It therefore does not lie in the mouths of intervenors to question, at the aggregate level, the cost estimates that have been developed through the buildup budgets and the budgetary iterations that the Company confirmed it used to develop its capital and O&M budgets.

Intervenors have, in effect, attempted to cast their failure to engage appropriate consultants and experts and/or to question the specifics of the Company's proposals as a failing by the Company. The evidentiary record is by no means tarnished because intervenors failed to engage and respond with their own evidence. Indeed, it is quite the contrary. The evidence of the Company is virtually unchallenged at the grassroots, program and operational activities levels.

Specific examples of this are the numerous suggestions, without specifics or evidentiary support of alleged over-forecasting. The mere assertion of over-forecasting in an argument is, of course, not evidence of actual over-forecasting. There must be some proof of the alleged over-forecasting. Intervenors could have brought forth a third party consultant or expert. They did not. Perhaps the inference to be drawn is that no credible witness was prepared to give such evidence. Regardless, the fact remains that there is no factual evidence of over-forecasting.

The Company utilized a detailed, "challenging" budgeting process, as Board Staff acknowledged,[256] which clearly demonstrated a concerted effort to develop budgets at the lowest reasonable cost while continuing to operate on a safe and reliable basis. There were numerous iterations of the capital budget.[257] During the process, departmental managers prioritized programs and operational activities, removed variable costs and embedded productivities and efficiencies. The evidence leads to the conclusion that the Company has, as many of its witnesses testified, likely under-forecast many of its costs.

Evidence that the budgets presented in this application are not overstated is found in the May 29, 2013 Enbridge 2013 Strategic Plan.[258] The Strategic Plan specifically notes the need for an increase in its capital investment program as a result of numerous initiatives, including the GTA and Ottawa Reinforcement Projects, WAMS, and the Integrity and Risk Management needs of the Company.[259] The Strategic Plan specifically recognizes that this significant increase in capital spending over the coming years will result in an annual revenue requirement much higher than what a traditional inflation minus productivity inflator methodology would provide. The Strategic Plan is factually consistent with the evidence in this Application. It goes on to set strategic objectives which will improve customer service, promote productivity and efficiencies and minimize operational risks. The Strategic Plan sets the Company on a course

[256] Board Staff Submission, p. 47.
[257] The capital budget process is described in detail within Ex.B2-1-1.
[258] Produced at Ex.J1.4.
[259] Ex.J1.4, p. 5.

which intervenors should welcome and support. The Strategic Plan is therefore evidence of a well-run utility and one incented to generate sustainable efficiencies in future.

b. Capital Budgets

The appropriate starting point to consider the reasonableness of the Company's capital budgets for the term of the Customized IR plan is the 2013 Actuals. As can be seen from the update filed February 18, 2014,[260] actual capital expenditures in 2013, excluding the GTA and Ottawa Reinforcement Projects, were $441.6 million versus $386.6 million Board-approved – an increase in capital spending of $55 million. In 2014, the Company is forecasting an increase of $38.5 million (again excluding the two Reinforcement Projects) driven primarily by the new Work and Asset Management System project (WAMS). WAMS adds a further significant component to the 2015 forecast of $25.7 million, and then $8.1 million in 2016.

The evidence demonstrates the rigour which the Company exercised in the development of its capital budgets. Exhibit K5.6, which contains a detailed list of each of the Company's capital budget programs and activities, compares the costs that were included in the first budget iteration against those included in the sixth and final budget iteration for each of 2014, 2015 and 2016. The budgeting process was further documented in the pre-filed evidence and by the many capital program witnesses that testified.[261]

FRPO spent a good deal of its argument, as it did at the hearing, referencing the changes over the last 8 years to applicable Technical Standards and Safety Authority (TSSA) Orders and requirements.[262] FRPO acknowledges the Company's detailed summary of the impact of these regulatory changes in its response to Undertaking J5.11. Importantly, FRPO does not suggest that the Company's summary of the

[260] Ex.B2-2-1, Table 2 Updated.
[261] See, for example, 4Tr.173-177.
[262] Final Argument of FRPO, pp. 4-11.

regulatory changes was wrong. Indeed, FRPO, restates precisely the Company's position that:

> It is clear the most important difference is the imperative "shall" in detailing components of the management programs in Clause 3.2 and the word "may" in the substituted Clause 12.10.13.11.[263]

FRPO then confirms that it agrees that there is a clear distinction. In short, FRPO is in agreement with the Company's interpretation of the regulatory requirements. This is also true of APPrO, which states that:

> APPrO acknowledges that legislative changes related to integrity management may be driving the need for some of the proposed changes.[264]

FRPO also makes an observation, which the Company submits is self-evident. It states that Enbridge was well aware of the direction of the new "Canadian Code".[265] Enbridge was certainly aware of the pending changes to applicable Codes in advance of them coming into force. The point being made in this case is that this is the first multi-year plan developed under the new regulatory environment. This knowledge of pending change is evident from the Company's greater capital spending needs in 2013 relative to the Board-approved amount. Much of this was due to integrity management programs, the driver for which was the regulatory change.

The fact is that the Company has been responding to the changing technical regulatory integrity requirements for assets operating below 30% of SMYS for a number of years. Table 1 from the response to SEC Interrogatory 111 demonstrates that a significant increase in system integrity and reliability spending took place in the years 2010 to 2012.[266] The evidence does not suggest and the Company did not intend to give the impression that its shift in thinking from a failure-based to management risk-based[267]

[263] Final Argument of FRPO, p. 8.
[264] Written Submissions of APPrO, p. 35.
[265] Final Argument of FRPO, p. 8.
[266] Ex. I.B18.EGDI.SEC.111, Table 1.
[267] Ex. J5.11, Attachment 2, p. 3.

approach to integrity management was done for the purposes of this proceeding, as appears to be the suggestion by FRPO. This is simply wrong. The Company's evidence is that the forecast level in capital spending over the term of the Customized IR plan is reflective of the new Code requirements which have been and will continue to be one of the drivers for the increases in capital spending.

Several intervenors suggested that the capital budgets do not reflect what the Company actually expects to spend over the term of the Plan.[268] To be clear, the Company has developed capital budgets which it believes represent the reasonable minimum cost to continue to operate its system safely, reliably and in compliance with all applicable regulatory requirements.[269] Its budgets are intended to provide the Board and ratepayers with confidence that there has been no over-forecasting and that it will be the Company that will be at risk if there is over-spending. Seeking approvals of the budgets at the lower end of a party's forecast is a benefit to ratepayers and should be welcomed. It is precisely because of the Company's expectation that there will be additional capital spending requirements, particularly in response to the ILI and MOP programs which could determine that pipeline replacement must occur at an accelerated pace, that the Company has requested the establishment of a Replacement Mains Variance Account in 2017 and 2018.

Another point raised by several intervenors relates to the alleged failure by the Company to produce third party capital spending benchmarking reports by qualified experts.[270] This Reply Argument has already addressed the intervenor arguments about benchmarking on an overall level. On a more specific level, in relation to capital spending, Enbridge has several further observations.

First, the statement is not accurate, in that the Company did engage experts who rendered opinions which have been filed in evidence. As discussed below, Sync

[268] See, for example, Final Argument of SEC, pp. 32-34.
[269] 4Tr.173-177.
[270] See, for example, Board Staff Submission, p. 45.

Energy undertook a benchmarking report for the purposes of the $67 million WAMS program.[271]

Second, the Company has proposed an AMP Fitting Replacement program, which may involve the replacement of approximately 320,000 AMP fittings that are prone to leak. This program forecasts capital expenditures of $8.5 and $13.1 million in 2014 and 2015, and $30 million in each of the years 2016 – 2018. In support of this program, the Company engaged two experts, both to study the program and to assist in the development of a realistic replacement program. The reports prepared by these experts, BANAK Incorporated, dated May 15, 2013, and Janna Laboratories Inc., dated July 30, 2013, were filed in evidence.[272]

Several intervenors also questioned the existence of the productivity savings embedded in the capital budgets.[273] The fact is that these productivities are embedded both at the aggregate and program levels. At the aggregate level, the Company is incented to generate efficiencies and productivities rather than over-spend relative to an approved budget. Seeking approval of capital budgets based upon forecasts which have removed significant variable cost components and which do not include the costs of expected capital requirements acts as an incentive to generate efficiencies, failing which the Company will find itself in a situation of over-spending which will not be addressed until the next rebasing. This is a powerful inducement.

At the program level, the numerous program managers who testified spoke to the specifics of their programs and how the programs will, in the long run, generate efficiencies and savings.[274] In addition, the Company was asked to quantify the extent of the anticipated productivity savings on the first day of the hearing. Its response is filed at Exhibit J1.6. Within the 2014-2018 capital budgets, these embedded savings

[271] Ex.B2-8-2, Attachment 1.
[272] Ex.I.B18.EGDI.SEC112, Attachments 2 and 3.
[273] See, for example, Final Argument of CCC, p. 12.
[274] See, for example, testimony given by witness panels 4 and 5.

total $162 million.[275] The Company also confirmed that its capital budget excluded variable costs with a total estimated value of $264 million.[276] While it is acknowledged that not all of these costs would be incurred, it was the testimony of Mr. Sanders that the capital budgets are based upon the lowest possible prudent plans and that the Company is at risk for these costs.[277] Although the Company went to great lengths to document, quantify and respond to any questions about the evidence, intervenors spent virtually no time on the specifics of the productivity savings and the variable costs which were removed from the forecast budgets. In short, intervenors have said they want the capital budgets reduced but point to no specific program or activity which they believe should not take place.

SEC's Final Argument referenced the Board's Decision in EB-2005-0001.[278] As noted by SEC, in that proceeding the Board approved an amount for the Company's capital budget for 2006, which was less than the amount requested. SEC is apparently asking the Board to do something similar in this proceeding.

What SEC does not acknowledge is that the circumstances in this case are different. In this case, Enbridge's proposed Core Capital budgets are higher than previous Board-approved amounts, but are very consistent with recent levels of actual spending in 2012 and 2013. That fits directly within the Board's observation in the EB-2005-001 case that

> The Board's role is to ensure that the Enbridge's total spending program is balanced in that it is not so low as to threaten the orderly maintenance and development of the system, nor so high as to place undue upward pressure on rates, either in the test year or some future period. <u>In fulfilling this role the Board attempts to place the capital spending plans within historical norms, which can be presumed to have found that appropriate balance.</u> If spending well in excess of historic norms is proposed, the Board must assess whether the increase is justified through the

[275] Ex.J1.6 pp. 2, 3 and 5.
[276] Ex.J1.6 pp.2, 5 and 6.
[277] 5Tr.94 and 164.
[278] Final Argument of SEC, p. 31.

> presentation of evidence regarding the Company's analysis, prioritization, and judgement respecting budget components.[279]
>
> (Emphasis added.)

The current case is not similar to the situation described in the EB-2005-0001 case, where a budget increase of over 80% was sought. Moreover, the main divergence in this case between Enbridge's historic and forecast spending relates to the GTA Project, which has already received OEB approval.

In this case, the Company has provided substantial evidence to justify its capital spending needs. It has clearly shown that it used a very detailed and analytical approach to the development of its budgets. It went through an extensive prioritization and variable cost elimination process and brought forward capital budgets which include the priority programs without the variable costs. It is clear from the professional engineers who testified in evidence, including Mr. Sanders and Ms Lawler, that there has been an appropriate exercise of professional engineering judgment in the determination of those programs which need to go forward. The Company submits that this is a case where the capital budget increases have been demonstrated.

c. WAMS

The WAMS project which the Company is undertaking is, as noted in the prefiled evidence and the oral testimony,[280] fundamental to core utility functions which include more than 1 million work requests per year and the scheduling of work to service more than 35,000 new customers per year. These functions have been undertaken through an outside contractor, Accenture, pursuant to the Envision Project which was approved by the Board in RP-2003-0203.[281] Enbridge entered into a 10-year contract with Accenture, which has been providing the services necessary for the Company to meet its work and asset management obligations. While this 10-year agreement has now

[279] Decision with Reasons, EB-2005-0001, p. 9, reproduced within Ex.K5.1.
[280] 6Tr.84 and 104-105; Ex.B2-8-2.
[281] The Envision Project was the subject of a Settlement Proposal (Issue 8.1), which was accepted by the Board on June 18, 2004. The Settlement Proposal is attached as Appendix B to the Board's Decision with Reasons, dated November 1, 2004, in RP-2003-0203.

expired, Enbridge has entered into an extension agreement with Accenture which will continue until early 2016.[282] This will allow the Company sufficient opportunity to select the appropriate vendors and roll out the WAMS program at the end of 2015.

One of the major drivers for the WAMS program is the fact that the existing technology being used by Accenture for the services that it is currently providing is becoming obsolete and has reached end of life. Specifically, Enbridge's manager of IT, Mr. Phagoo, stated in testimony that the specific issue in respect of the existing technology is that the underlying platform itself is written in very old language. It is very dated and the vendor is no longer willing to support the product.[283]

The Company filed detailed evidence about its need for the functionality to carry on its operations and the various options which were considered to replace the existing technology including a review of the current vendor's new product offerings.[284] The prefiled and oral evidence also provided detailed information about the extensive steps taken by the Company to develop the budget for the WAMS program.[285] Consultation with North American utilities, system vendors, system integrators and industry experts was undertaken. This was outlined and confirmed in the prefiled and oral evidence.[286] Finally, the Company retained Sync Energy to undertake a third party expert benchmarking exercise and their report is filed in evidence.[287] This third party benchmarking exercise was undertaken to validate the reasonableness of the proposed WAMS Program, including scope, budget, approach and methodology, industry trends and technology options considered by Enbridge.[288]

Despite all the detailed pre-filed and oral evidence and the retainer of a third party expert to undertake a benchmarking exercise, certain intervenors have, in effect,

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282 6Tr.86.
283 6Tr.98.
284 6Tr.99. Options outlined in Ex.B2-8-2, pp. 12-16.
285 6Tr.86-86 and Ex.B2-8-2.
286 Ex.B2-8-2 and 6Tr.121.
287 Ex.B2-8-2, Attachment 1.
288 *Ibid*.

requested that the Board not consider the capital and O&M costs of the WAMS initiative within amounts to be recovered in rates during the IR term.[289]

It is clear from the evidence that the WAMS project, being core to Enbridge's functions, is needed and that the project will deliver the necessary functionality required by the Company. Intervenors have not adduced evidence nor made argument to the contrary. This, of course, is the result of the fact that intervenors recognize that the current services provided by Accenture, which will end in early 2016, must be provided by some other means, and the most cost-effective solution which the Company has identified is the WAMS project.[290]

SEC in argument asks the Board to remove the impact of the WAMS project from the Company's revenue requirement, for several reasons[291], all of which are mistaken. First, it is argued that the O&M budget fails to exclude the reduction in payments to Accenture once the Accenture extension terminates in 2016. Mr. Akkermans, under cross-examination, confirmed[292] that the $888,000 O&M expense associated with the Envision project costs was removed from the O&M budget in the years 2016 through 2018. Consistent with the testimony of Mr. Akkermans, Mr. Kancharla confirmed under cross-examination of the O&M panel that the WAMS O&M IT component is $4.1 million per year, which is an incremental increase of $3.2 million over the approximate $900,000 O&M costs in respect of Envision.[293] This is also demonstrated by the Company's response to SEC Interrogatory No. 97.[294] This same interrogatory response notes that the O&M costs of the WAMS project appear for the first time in the O&M budget in 2016 and continue for the balance of the IR term.

Contrary to SEC's suggestion that O&M costs associated with the Envision Project should be removed from the 2014 O&M budget, Mr. Akkermans confirmed that O&M

[289] See, for example, Final Argument of SEC, pp. 58-59.
[290] 6Tr.156.
[291] Final Argument of SEC, pp. 58-59.
[292] 6Tr.148.
[293] 8Tr.98-100.
[294] Ex. I.B18.EGDI.SEC.97.

costs for Envision will continue to 2016 due to the Envision Extension.[295] Furthermore, as indicated by Ms Torriano in response to a question from Ms Chaplin, the Systems Operations Department will continue to incur O&M costs at a level similar to those incurred under the Envision Project when the WAMS system is up and running, and these amounts are in addition to the $4.1 million of IT O&M costs.[296] There is, therefore, no basis for reducing the O&M budget at any point in time during the IR term as suggested by SEC.

SEC has also erroneously suggested that there is some amount in the capital budget which also needs to be removed with the expiration of the Accenture contract and the roll out of WAMS.[297] The Company's response to SEC Interrogatory 97 clearly demonstrates that Envision capital costs cease on conclusion of the existing Envision service contract, with the amount included in rate base for Envision declining in the years 2016 through 2018. By comparison, the capital costs of WAMS are primarily incurred in 2016. Therefore, the capital budget does not include any amounts for the Envision project after the extension agreement expires in 2016, through the end of the IR term. For the amount of capital costs in respect of the Envision Extension that are incurred in early 2016, the Company will have to manage these costs within the proposed capital budget envelope.[298]

Finally, SEC postulates that the savings that the WAMS project might generate could make up the balance of the incremental costs of the WAMS project.[299] There are a number of problems with this theory. First, SEC has neglected to recognize that WAMS will not be up and running until the very end of 2015, with the warranty and stabilization period extending into mid-2016.[300] There can and will be no savings or benefits

[295] 6Tr.86.
[296] 7Tr.199.
[297] Final Argument of SEC, pp. 58-59.
[298] 6Tr.133.
[299] Final Argument of SEC, p. 59.
[300] 6Tr.130.

generated until the program is launched and potential benefits, if any, would not be possible until late into the IR period.[301]

Second, as noted by Mr. Akkermans under cross-examination by counsel to SEC, given the state of the WAMS project where the Company is only now selecting the system integrator, it is difficult to articulate the benefits and the potential for incremental costs that may arise once the WAMS program is rolled out.[302] As noted by Mr. Brophy in testimony,[303] to the extent that WAMS is able to facilitate the generation of benefits, these benefits would be shared by ratepayers and the Company through the ESM which the Company has proposed.

It is unfair to be critical of the Company for not including in its evidence the assessment of the benefits which may arise once the WAMS program is rolled out given that the development of the program is only in its very early stages. To first be critical of the Company for not estimating the savings that may arise and to then suggest that $20 million in savings will arise is a contradiction in itself as it confirms that there is no evidentiary basis for the figure. The Company notes that the Board did not require Enbridge to fund Accenture's services through the benefits generated over a 5 year IR period. The mere fact that Enbridge is now bringing the same functionality in-house is not a proper basis to treat WAMS on a radically different basis and disregard its impact on the revenue requirement.

In summary, it should be recognized that the Envision project has continued now for approximately 10 years at an annual capital cost of under $9 million. By comparison, the capital costs of the WAMS program are approximately $67 million and while they will be primarily rate based in 2015 and 2016, assuming that the replacement technology which is installed in-house at Enbridge has a 10-year life expectancy, the capital costs of the WAMS project represent a savings in capital costs of approximately $2 million per

[301] 6Tr.86.
[302] 6Tr.104.
[303] 6Tr.105.

year. Because of the size of the project and its initial capital costs, the WAMS project cannot be managed through a normal capital budget envelope.[304]

The Company submits that the Board should have confidence in the budget developed for WAMS not only because of the quality of the evidence, but also given the fact that the competitive RFP process for the selection of the software vendor which has now been completed came in at a cost in line with the Company's estimates.[305] While WAMS will provide the Company with the internal ability and functionality to meet its work and asset management requirements, the need for this functionality is not new. It was understood when the 10 year Envision Services agreement was put in place that an assessment and action may be required.[306] Although a separate business case in the traditional sense was not filed, the business case elements filed by Enbridge in its evidence clearly outline the drivers for WAMS, options assessed, the methodology for making the decision and why the WAMS Program is the most cost effective option. The Company appropriately proceeded to evaluate all reasonable alternatives and to select the most cost efficient solution. Enbridge respectfully requests approval of the costs outlined in its evidence.

d. O&M Forecasts

As acknowledged by Board Staff[307], within the O&M cost forecasts it is Other O&M that is truly at issue in this proceeding. Customer Care/CIS, DSM, and Pension/OPEBs are dealt with through other proceedings or are the subject of approved mechanisms. The Company submits that any consideration of the reasonableness of its Other O&M forecasts for the IR term must take into account that Enbridge's 2013 Other O&M Actual expenses exceeded Board-approved by $5.5 million.[308] The Company spent $224.7 million on Other O&M activities in 2013 and is seeking approval for an increase to only $228 million in 2014, a difference of only $3.3 million, or 1.4%, as noted by Mr.

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[304] Ex.B2-8-2, p.2.
[305] 6Tr.86.
[306] 6Tr.157.
[307] Board Staff Submission, p.46.
[308] Ex.D1-3-1, Table 1 Updated.

Kancharla in oral evidence.[309] Despite the level of spending in 2013, the Company has not sought any adjustment to its forecasts for the IR term.

A second important consideration which should be identified is that beginning in 2016, the O&M budget increases by $4.1 million per year to reflect the O&M expense associated with the WAMS project. As noted elsewhere in this Reply, WAMS replaces the Envision Project which had a total capital and O&M annual cost of approximately $9 million, which will cease once WAMS is operational. The incremental cost of WAMS is important because intervenors have deliberately attempted to make the Company's Other O&M forecasts look like significant increases, when in fact, excluding WAMS, the increases do not reflect the full amount of forecast inflation and the O&M impact of the forecast growth in customers. Indeed, as noted by Mr. Kancharla in evidence,[310] counsel to SEC added the WAMS O&M costs of $4.1 million in each of 2016, 2017 and 2018 to his Exhibit K7.3 for the purposes of trying to suggest that the Other O&M forecast expenses were inflating at a rate higher than what is appropriate.

The fact is that the inflator used by the Company for its O&M forecasts is less than the combined forecast of inflation and the forecast costs of future customer growth. As noted in evidence by Mr. Lapp, the organic growth of the Company is expected to continue at a rate of 1.7 to 1.8% per year.[311] The inflator used by the Company for final budgeting purposes was approximately 2%. It is self-evident that this rate does not account for the full impact of both customer growth and forecast inflation. The full amounts of these cost pressures have not been factored into the O&M budget forecasts.

The reasonableness of Enbridge's O&M forecasts are proven by other means as well. The Company has kept its FTEs flat for the term of the Customized IR plan.[312] The O&M budgets do not include amounts for additional FTEs beyond the 2013 base. This

[309] 7Tr.25.
[310] 7Tr.209.
[311] 7Tr.29 and 48 (Mr. Kancharla).
[312] Ex.D1-3-1, pp. 1-2.

is actually an extraordinary commitment considering the significant increase in capital projects which the Company plans to undertake. Stated differently, the Company, from a rates perspective, will have to manage its operations and its capital programs using the same complement of FTEs as it did in 2013, even with the continuation of customer growth and its integrity management plans.

This should be seen for precisely what it is – an embedding of productivity into the Customized IR plan. Indeed, the fact that the inflator used by the Company to develop its O&M budgets does not include the aggregate of customer growth and inflation, combined with the commitment to hold FTEs flat, amounts to both an embedded productivity and stretch factor. Accordingly, the suggestion by Board Staff that an additional stretch factor might be appropriate would amount to a doubling up on the productivity/stretch factor which is already embedded in the Customized IR plan.[313]

One intervenor argued that FTEs are flat because of vacancies.[314] There are always vacancies with people leaving and retiring at different points during the year. This fact has always been recognized by the Company. For this reason, its 2013 budget included a 2.5% credit (i.e., a 2.5% reduction in forecast salaries) to reflect vacant positions. Stated differently, the Board-approved Other O&M budget in 2013 embedded in it a 2.5% reduction to employee-related expenses to reflect the average number of vacancies that exist. As this credit exists in the base case, it would be inappropriate to then decrease the 2014 forecast by the same amount when the Company is holding the number of FTEs flat. Once included in the base, the 2.5% credit is reflected in the forecast for each year of the Customized IR plan. This was explained thoroughly by Mr. Kancharla under cross-examination by counsel to CME.[315] No argument was made suggesting that Mr. Kancharla's math was wrong.

[313] This issue is discussed in more detail in the previous section of the Reply Argument.
[314] Written Submissions of APPrO, pp. 37 and 45-46.
[315] 7Tr.164-165.

CCC suggested that the Company should have gone further than it did in terms of its evidence to demonstrate the reasonableness of its O&M forecast.[316] It is difficult to understand the basis for such an argument. In addition to the pre-filed and oral evidence of departmental managers, the Company confirmed in evidence that its costs per customer have remained relatively flat and will decline over the IR term.[317] As well, the Company retained Concentric and produced in evidence a report from Concentric showing that Enbridge's forecasted O&M costs are reasonable based on a comparison to the benchmark utilities, and in relation to productivity from the seven company sub-group PFP analysis.[318] All of this, together with a comparison to historic actuals, the Company submits, provides a solid evidentiary foundation for the forecast.

Several intervenors were critical of the details provided by the Company of embedded sustainable efficiencies. The Company submits that is truly unfair. First, by holding FTEs flat and by including an inflator which, in effect, includes a productivity and stretch factor, the benefits of the Company's Custom IR proposal will be sustained over the term of the plan. These amounts were quantified in the Company's response to Board Staff Interrogatory No. 19, which shows that the embedded savings total between $24.1 million and $43.3 million annually.[319] Not only are these savings sustained, the savings accelerate over time.

Intervenors presumably did not attack the Company's evidence about the expected cost pressures it will face over the term of the Customized IR plan because they recognize the reality of these cost pressures. There are numerous examples detailed in both the pre-filed and oral evidence. Examples include the evidence of Ms Torriano[320] which confirmed that the budget does not account for known and expected cost increases such as contractor unit rate increases and benefits which often exceed the rate of inflation because many outside contractors utilize a unionized workforce whose wage

[316] Final Argument of CCC, p. 14.
[317] Ex.K7.1, p. 9; Ex.D1-3-7, pp. 20-23.
[318] Ex.A2-9-1.
[319] Ex.I.A2.EGDI.Staff.19 and TCU3.14.
[320] 7Tr.35.

increases are a matter of collective agreements. Ms Torriano also acknowledged that the Bad Debt expense had been held flat over the IR term.[321] Ms Trozzi confirmed that not only has the Company held its FTE complement flat, it budgeted only on the basis of a 2% annual increase in salaries; yet the Company believes that 3% increases will be necessary to remain competitive.[322] Ms Trozzi also confirmed that benefits were forecast to increase only at a 2% annual level; yet the expectation is that the benefits will increase annually at a rate of 6%. The difference between the forecast and the expected actual is an embedded productivity because the Company is being forced to operate with a budget below expected costs. Enbridge must either be productive or incur the consequences of overspending without recovery.

In addition, the Company gave detailed evidence about programs that will generate sustainable efficiencies. For example, Mr. Lapp gave extensive oral evidence about the benefits of the use of GPS technology.[323] The Board will recall that counsel to SEC complained that Mr. Lapp's oral evidence in chief was not based upon the written record. The Company volunteered to provide the details of the written evidentiary basis for Mr. Lapp's evidence in chief and did so in its response to Undertaking J7.3. Not only was no further complaint made, intervenors have simply avoided addressing the detailed evidence of the Company about its plans to generate sustainable efficiencies over time through programs like the use of GPS technology.

No intervenor argued that the Company needlessly overspent in 2013. There is no suggestion that improper or unnecessary spending occurred. Accordingly, the 2013 Other O&M actual figure is the best evidence of the actual spending needs of the Company, and this very much supports the Other O&M forecasts.

Finally, SEC argued that the recent Union Gas Settlement would work for the setting of Enbridge's Other O&M budgets for the term of the Plan.[324] SEC's argument, of course,

[321] 7Tr.36.
[322] 7Tr.37.
[323] 7Tr.27 to 35.
[324] Final Argument of SEC, p. 45.

does not account for the incremental increase in the annual O&M budget beginning in 2016 due to WAMS. This fact alone makes the Union Gas Settlement inappropriate. That being said, at the end of the day, it is the results which count, and Enbridge submits that the methodology it has used for the development of its Other O&M budgets is sound, fully supported in evidence and, most importantly, reasonable from a ratepayer's perspective.

e. RCAM

The development of the Regulatory Cost Allocation Methodology (RCAM) has been the subject of review and analysis by several experts and detailed consideration by the Board in the past, with the most recent instance being the 2013 rates case[325] in which Enbridge, once again, retained MNP to undertake a detailed review of the Company's use and the appropriateness of the methodology. MNP's Final Report dated May 17, 2012 was filed in evidence and was relied upon by the Company, parties and the Board for purposes of facilitating a settlement, which included in rates for 2013 the sum of $32.1 million for corporate cost allocations.

The purpose of RCAM is to ensure compliance with the *Affiliate Relationships Code* and to ensure that the three-prong test developed by the Board to determine appropriate corporation cost allocations is satisfied. Part of the methodology involves stakeholder consultations. While the Company is not obliged to continue the RCAM consultative beyond 2012 pursuant to the RCAM supplementary Settlement Agreement of September 27, 2007 agreed to in the EB-2006-0034 proceeding, as proposed in this Application[326] and later confirmed by Mr. Chhelavda under cross-examination, the Company believes that there is merit in continuing with the RCAM consultative during the term of the IR Plan.[327] The Company intends to reconvene the RCAM consultative process in late 2014 or early 2015 to share the 2013 and 2014 RCAM numbers under the Inter-corporate Service Agreement with intervenors.

[325] EB-2011-0354.
[326] Ex.D1-4-1.
[327] 7Tr.89.

The RCAM forecast filed for 2014 is $35.28 million.[328] This figure was calculated by applying the expected rate of increase adjusted by other RCAM-specific factors as appropriate to the line items of the preliminary 2013 figures. It should be recalled that MNP undertook a detailed review of the Company's RCAM results in 2012 and filed a detailed opinion setting out its opinion in respect of the financial results. These results were accepted by the Company and the resulting amount was adjusted for the purposes of developing a 2013 result. With the approval of the 2013 Other O&M amount which included $32.1 million in respect of RCAM, it appears that the Board and intervenors were satisfied with how the RCAM was working. This figure did not require RCAM Consultative review as there was no 2013 ESM proceeding to in effect true up actual results.

As can be seen from the evidence,[329] the RCAM generated figures for the years 2014, 2015 and 2016 actually decline in each year relative to the previous year. This demonstrates that the RCAM methodology is working appropriately, as the percentage of Enbridge Inc.'s (EI) budget which is allocated to Enbridge is decreasing given that Enbridge is, over time, becoming a smaller fraction of the EI enterprise.

The RCAM forecasts for 2017 and 2018 simply reflect the Company's forecasting for these years using the same rate of increase which was applied to its Other O&M budget, adjusted by other RCAM-specific factors as appropriate. These amounts are forecasts and, as noted by Mr. Chhelavda in evidence, will be treated in a similar fashion as RCAM amounts which were included in base rates during the first IR term.[330] Any variance of RCAM amounts included in rates and eventual amounts produced by the approved methodology will be reflected in actual results as part of the annual ESM process.

The figures proposed as RCAM forecasts in this proceeding have been the subject of the interrogatory, Technical Conference and Oral Hearing processes, which provided

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[328] Ex. D7-4-1, Attachment 1.
[329] *Ibid*.
[330] 7Tr.90 and 104.

opportunities for intervenors to ask questions about the 2013 actuals and the 2014-2018 forecasts. As a result, it is submitted that there has been full opportunity for review of these forecasts and the approval of the forecast amounts is appropriate.

Board Staff propose that the RCAM results be subject to a thorough consultative review before being placed into the new IR Plan.[331] It is not clear precisely what Board Staff are contemplating, but the Company is proposing the continuation of the RCAM Consultative which would in each year of the Customized IR plan thoroughly examine the actual results generated by the RCAM. If through the Consultative process there is agreement that changes should be made to the actual RCAM amounts for any year during the IR term, then that change will be reflected within the RCAM amount that is used within the ESM proceeding for that year.

In respect of those intervenors that advocate the discontinuance of the RCAM[332], either in whole or in part, the Company is mindful of the fact that RCAM was generated for the purposes of ensuring the reasonableness of amounts being included in rates for its corporate cost allocations. There is no evidence that the methodology is not working or that it has been inappropriately applied. There is also no evidence that the methodology requires any significant amendments to continue to function as designed. In respect of the several refinements which MNP proposed earlier which have not been accepted by the Company, the Company believes that for the reasons set out in its pre-filed evidence,[333] and as stated by Mr. Chhelavda in testimony, these changes could be costly to implement and might reduce transparency.[334]

f. Municipal Taxes

Energy Probe, one of the only intervenors that commented on municipal taxes, accepts the Company's figures for the period 2014 through 2016.[335] As the increases are

[331] Board Staff Submission, p. 50.
[332] See, for example, Final Argument of Energy Probe, p. 27.
[333] Ex.D1-4-1, pp. 3-9.
[334] 7Tr.175-6.
[335] Final Argument of Energy Probe, p. 31.

reasonable in those years, it follows that using a similar rate of increase for 2017 and 2018 is also reasonable, including an appropriate recognition of the impact of the integrity management programs. The fact is that if the Company undertakes significant replacement of its mains, as it believes will likely be necessary as a result of its integrity management programs, this will have a net increase in the property assessment/taxes as the replacement mains will not be depreciated compared to the old mains which are replaced. It should be noted that under Ontario Regulation 338/12, Table 5, older mains can be depreciated to a maximum extent of 80% for property tax assessment purposes.[336]

Intervenors devoted little of their Argument to municipal taxes likely due to the fact that municipal taxes actually incurred in 2013 exceeded the $39.3 million figure which was included in the 2013 ADR settlement as a result of the Company's agreement to accept an $800,000 reduction in its forecast. Ms Swan confirmed that the 2013 Actuals are in the $40 million range.[337] The increases in municipal taxes over the term of the Customized IR plan are attributable to inflation assumptions (1.39, 1.64 and 1.72 percent for the years 2014 through 2016), <u>and</u> the anticipated growth in assessable net plant resulting from: (i) the Company's land acquisitions; (ii) the new training centre in Markham; (iii) the significant customer growth which will continue throughout the term of the plan; and (iv) the significant leave to construct projects which will also be completed during the term of the IR plan.[338] Stated differently, not only will municipal taxes likely increase at a rate equal to or greater than the rate of inflation, the Company's assessable net plant will also increase over the term of the plan and some of the increase is due to such growth.

[336] The fact that new pipeline regulated tax rates were implemented starting in 2013 is described at Ex.D1-6-1, p. 2.
[337] 7Tr.20.
[338] 7Tr.21 and Ex. D1-6-1.

g. Other Revenues

The Company is forecasting a decline in Other Operating Revenue in 2014 versus 2013 Board-approved. This is due primarily to lower late payment penalties in 2014, which are held at the 2012 level. In comparison, 2013 Board-approved was higher because it under-estimated the LPP reduction resulting from the implementation of customer service rules, and the 2013 Board-approved assumed higher billed receivables driven by colder weather.[339]

Energy Probe suggests that the Company has under-forecast other revenue amounts in this Application[340], yet it fails to note that the Company actually had over-forecast other operating revenues from the perspective of 2013 Board-approved versus 2013 Actuals by $3.1 million primarily due to the decline in LPP revenues, new account and red lock charges.[341] The Company views its forecasts in respect of Other Revenue, particularly in respect of LPP revenues, as being reasonable, especially given the fact that it believes it has likely under-forecasted Bad Debt expense.[342] If there is to be an updating or revision to reflect minor variances in Other Revenues, the Company submits it would also be reasonable to update for the actual Bad Debt expense. This, of course, only adds greater complexity and uncertainty in respect of future rates as this would presumably have to be undertaken every year.

Finally, it is appropriate to note that what Energy Probe is proposing is inconsistent with the argument made by several intervenors that Enbridge is trying through its Customized IR plan to avoid or reduce risk. Here and in other instances, such as Customer Growth forecasts, Energy Probe is proposing annual updates. Yet such updates would have the very effect complained of by intervenors, namely, a reduction in the forecast risk which the Company has assumed.

[339] Ex.C1-1-1, Updated, para.18.
[340] Final Argument of Energy Probe, p. 32 and 38.
[341] Ex.J1.2, p.4, 5, Reference (b).
[342] As discussed in Undertaking J1.6

h. Customer Additions / Volume Forecasts

Within its Final Argument, Energy Probe asserts that there should be adjustments (increases) to the Company's customer additions forecasts, and corresponding changes to the Company's 2014 volumes budget.[343] As explained below, this is not necessary or appropriate.

The Company's forecast for Customer Additions in pre-filed evidence[344] includes the following forecasts:

Total Gross Customer Additions

Settlement Agreement 2013	Budget 2014	Budget 2015	Budget 2016
38,896	36,647	38,489	39,645

Customer Additions are driven, to a large extent, by the key economic assumptions and in particular those which relate to Enbridge's three operating regions. What is notable is that there was a downward estimate in respect of the housing starts forecast for 2014 in the update of the economic outlook filed in response to an undertaking given at the Technical Conference[345] relative to the economic outlook which was filed in June 2013.[346] The forecasts for housing starts in each of the GTA, Eastern and Niagara regions in the more current economic outlook showed a decline in housing forecasts for 2014 of more than 3,000 units. This is consistent with the Company's forecast in evidence that there would be a decline experienced in 2014, as demonstrated in the above figures.

As well, the update of the economic outlook also demonstrated a decline in 2013 Actuals relative to the earlier economic outlook. The forecast in June 2013 was for a

[343] Final Argument of Energy Probe, pp. 37 and 39.
[344] Ex.B3-2-1, p.1.
[345] Ex.TCU3.11.
[346] Ex.C2-1-1, pp.1, 2.

total of 41,700 housing starts in the franchise areas. The more current economic outlook[347] indicates that there was a decline in actual housing starts versus what was originally forecast and included in evidence.[348]

In light of this evidence, there is no basis for any upward adjustments to Enbridge's customer additions forecasts, as proposed by Energy Probe.[349]

There are several additional problems with what Energy Probe has proposed. First, Energy Probe references a figure for Rate 1 customers of 33,098 in 2014. This is the increase in average customer meters forecast for 2014, which is noted in pre-filed evidence.[350] This is not comparable to the gross customer additions forecast. Second, the fact is that the Company has employed the same methodology, using a number of sources, consistent with the approach used by the Company in previous rate applications. This methodology has been accepted in previous settlement proposals and Board decisions.[351] No compelling reason was given for the proposal to deviate from the use of this methodology.

A further problem with Energy Probe's proposal is its characterization of the housing market as having strengthened more than the original forecast filed by Enbridge. As noted above, the economic outlook evidence in fact confirms Enbridge's customer additions forecasts showing a decline over the economic outlook figures as filed in June 2013. There is, therefore, simply no basis in evidence to increase the forecasts for residential customer additions.

The same is also true in respect of Rate 6 customers. The more current economic outlook[352] indicates a worsening in the forecasts for 2014 of commercial and industrial vacancy rates in the GTA. An increase in such vacancy rates is consistent with the

[347] TCU3.11.
[348] Ex.C2-1-1, p.2.
[349] Final Argument of Energy Probe, p.37.
[350] Ex.C3-2-2, p.1
[351] Ex.B3-2-1, p.2.
[352] Ex.TCU3.11.

Company's forecasts for 2014 of a slight decline in commercial and industrial customers.

In response to Undertaking J7.1, the Company confirmed, in hindsight, that there were two customers added since the forecast was done. Energy Probe argued that the volumes forecast for 2014 should be updated for these two customers.[353] The fact that Enbridge is aware of two customers coming online is a reflection of the timing of this Application being in the second quarter of 2014. It is not a reflection of the appropriateness of Enbridge's forecasts. Forecasts are precisely that, and there will be times when customers and volumes are over-forecast and times where there has been an under-forecast, but to continually update forecasts to reflect actuals in the test year is an endless and time consuming exercise which will go in either direction.[354]

APPrO questions Enbridge's forecasts for contract customers.[355] This concern does not appear to acknowledge the evidence of Ms Suarez that the change in contract customers reflects the migration of customers between Rate 6 and the Large Volume classes. This migration is not necessarily indicative of unfavourable conditions but rather a change in operating realities for customers.[356] Ms Suarez further added that ultimately customers know their needs best and are cognizant of their potential for growth in a particular year to which they are willing to commit. These customer volumes are included, but for customers that are less certain Ms Suarez confirmed that their volumes should not be counted until the customers have entered into a contract and are able to make a decision about the volumes they will require.[357]

An undertaking was given to provide an estimate of any additional customers in Rate 6 or a contract rate class and their volumes and revenues that were not included in the 2014 budget, beyond the two customers identified in response to Undertaking J7.1.

[353] Final Argument of Energy Probe, p. 39.
[354] Undertaking J7.1
[355] Written Submissions of APPrO, pp. 46-48.
[356] 7Tr.13
[357] 7Tr.14/15.

Enbridge confirmed in its undertaking response[358] that there are no additional Rate 6 or contract rate customers who are expected to come online in 2014 that were not captured in the 2014 budget.

Energy Probe also argues that in future rate adjustment proceedings, Enbridge should be directed to include an allowance for volumes from potential customers who have not yet signed contracts.[359] The Company disagrees that this is necessary or appropriate. Enbridge in its pre-filed evidence and the oral testimony of Ms Suarez, both at the Technical Conference and under cross-examination by Mr. Wolnik, confirmed the process that Enbridge follows in respect of commercial and industrial customer forecasts. Where the customer is known and there are arrangements for a new customer to come online, that customer's volumes would be included in the forecast. However, it is not possible to incorporate incremental volumes mid-year arising from new customers that were not foreseen or expected to come online.[360] Another reason Ms Suarez gave for not attempting to include every possible customer in a forecast is the uncertainty of the timing of when a potential customer will come online and the volumes that the customer will take.[361] The process followed does capture material new loads. For example, in respect of a specific power producer, this new customer's volumes were included because Enbridge was aware of the customer coming online.[362]

As a final point on this topic, Enbridge questions the appropriateness of updating any forecasts in isolation. For example, if forecasts of revenue drivers are to be updated, then should the Board also include updates for cost drivers? By way of example, if customer addition forecasts change for volumes purposes, there should be corresponding changes to the capital expenditures forecast for customer additions. Also, if one area of forecasts is updated to use more current information, then why

[358] J7.2
[359] Final Argument of Energy Probe, p. 39.
[360] Technical Conference, January 20, 2014, pp. 48-49.
[361] 7Tr.11 and response to TCU3.9.
[362] Technical Conference, January 20, 2014, p.50. Specifically, the question related to the Durham York Energy Centre. Enbridge confirmed that its forecast volumes were included in the application under Rate 6. Ex.TCU3.10.

aren't other areas updated to the same dates. In the Company's view, there should be no isolated updating. As already explained, to continually update forecasts to reflect actuals in the test year is an endless and time consuming exercise which will go in either direction. In Enbridge's view, and contrary to the arguments put forth by intervenors that Enbridge's plan shifts risks to ratepayers, the use of forecasts at a point in time is exactly the type of risk exchange that is resident within any 5 year IR framework. Ratepayers receive the certainty (i.e. less risk) of Allowed Revenue growth, while the Company takes the risk that revenue drivers will materialize as predicted and that costs and cost drivers can be managed within the Allowed Revenues.

It should be noted, however, that the Company is proposing to update its volumes annually as part of the annual rate adjustment proceeding.[363] This will properly balance the forecast risk to ratepayers and the Company. Therefore, while there is no proper basis to update only particular aspects of the Company's forecast 2014 volumes, there will be opportunity to review the forecast volumes budget for each subsequent year of the IR term during the annual rate adjustment proceedings.

<u>i. Average Use</u>

Within its Final Argument, Energy Probe asserts that Enbridge's 2014 average use forecast should be increased.[364] Again, this is not justified by the evidence in this case.

In its prefiled evidence, the Company sets out in detail the average use forecasting model which it used to forecast average use for certain Rate 1 and Rate 6 revenue classes.[365] As noted in evidence, the econometric methodology which the Company used has been in place since 2001, and the resultant forecasts have been accepted in settlement proposals and Board decisions since.[366] The primary goal of the average use forecast is to be accurate and objective. In support of this, besides testing historic

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[363] 7Tr.13.
[364] Final Argument of Energy Probe, p. 40.
[365] Ex.C2-1-3.
[366] *Ibid*, pp.1-2.

forecast accuracy, the forecast models were subjected to a battery of diagnostic tests which have determined that they are statistically valid.[367] The econometric models have generated forecasts with a high level of accuracy[368] which demonstrate the effectiveness of this approved predictive approach.

Major driver variables to the average use forecast are natural gas prices and the economy. Sharp increases can influence customers' fuel use habits, for example, by the lowering of thermostats, and can influence decision making in respect of major purchases, such as more fuel-efficient furnaces and other appliances.[369] Similarly, employment, vacancy rates and the pace of economic growth can influence natural gas consumption across all sectors.[370]

The Company's forecasts, as determined by its use of the forecast methodology, are set out in pre-filed evidence.[371] While the forecast reduction in 2014 versus 2013 Board-approved was 2.21%,[372] when compared to 2013 Actuals, the decrease is 1.8%, which is in line with expected natural gas prices and the economic outlook forecasts.

The Company has previously noted that the reduction in average use of 2.21% stemming from the 2013 Board-approved average use to the 2014 Forecast is not an appropriate comparison.[373] The 2013 Board-approved average use was developed in an earlier proceeding using assumptions that were relevant at that point in time. Using the economic assumptions contained in the pre-filed evidence[374], the forecast average use for 2014 is consistent with the historical trend and should continue to be applied as proposed in accordance with the approved methodology.

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[367] *Ibid*, pp. 8-20.
[368] *Ibid*, pp 7-8.
[369] *Ibid*, p.20.
[370] *Ibid*, p. 22.
[371] Ex.C1-2-1, Appendix A.
[372] Ex.C1-2-1, Appendix A, p. 3.
[373] Ex.I.C25.EGDI.EP.31.
[374] Ex.C2-1-1, pp.1, 2.

Energy Probe argues that the Rate 1 average use forecast for 2014 should decrease by 1.3% from the 2013 Board-approved level.[375] It points to historical changes and suggests that the 2014 forecast change is out of the ordinary, but it neglects to note that larger decreases were experienced in 2005 and 2006. The Company submits that Energy Probe's proposal for a decline in average use of 1.3% from the 2013 Board-approved forecast, without any analysis or methodology being presented for review and testing, is inappropriate and should not be accepted by the Board.

Similarly, Energy Probe proposes, without any supporting evidence or methodology, that the average use per customer for Rate 6 should be maintained at the 2013 Board-approved level rather than the forecast generated by the average use forecast methodology utilized by the Company.[376] There is simply no basis in evidence for what Energy Probe proposes.

It should be noted that no questions were asked of Company witnesses in respect of the average use methodology and the forecasts generated, nor were they asked about the proposed revisions to the forecasts now suggested by Energy Probe. The Company submits that it would be inappropriate and set an unwelcome precedent for the approval of unsubstantiated and untested forecasts in the manner proposed by Energy Probe.

j. 2013 Revenue Sufficiency

While it may have been predictable that some intervenors would argue for an adjustment to base rates for the 2014 through 2018 period simply as a means to slash Allowed Revenues, what is surprising is the failure by intervenors to identify and even attempt to discount the evidence which clearly demonstrates that any such adjustment due to the 2013 revenue sufficiency is inappropriate. It should be recalled that intervenors asked for an opportunity to question Company witnesses after the release of its 2013 financial results. The Board permitted this to occur, despite not being part of

[375] Final Argument of Energy Probe, p. 40.
[376] *Ibid*.

the original hearing schedule. Counsel for SEC and CME then undertook a detailed cross-examination of Company witnesses on Days 9 and 10 of the hearing.

In response to this questioning, Messrs. Culbert and Bhatia gave thorough and comprehensive explanations as to what occurred in 2013. Despite this, and with counsel for CME apparently acknowledging that it is appropriate to understand the details of what took place in 2013, and whether that impacts on the risk of the filed forecasts for 2014 to 2018[377], intervenors did not delve into or refute in their arguments the explanations given for the 2013 revenue sufficiency. In short, intervenors have simply taken the position that there should be an adjustment to the base in an amount equal to the sufficiency of $31.2 million identified in Exhibits J1.2 and K9.2.[378]

Before turning to the explanations given for the revenue sufficiency in 2013, it is appropriate to first acknowledge certain important facts. The uncontradicted evidence of Mr. Culbert is that the revenue sufficiency in 2013 does not in any way, shape or form mean that there is much less risk in the 2014 through 2018 forecast. Mr. Culbert identified this specifically in response to questions from counsel for CME. [379] There is no evidence which confirms that there has been any change to the forecast risk for these years.

The effort by the intervenors to see the 2014 base reduced by the entire $31.2 million revenue sufficiency should also be seen for what it is. Being a cost of service year, 2013 did not have an ESM process. Intervenors are, in effect, attempting to not only introduce an ESM into the 2013 mix, after-the-fact, they are looking to receive 100% of the benefits. This would be significantly in excess of any earnings sharing that would have occurred under the ESM that was in place during the 2007 through 2012 period. Indeed, intervenors are looking to entrench this level of benefits, not only for one year, but for the entire IR term.

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[377] 10Tr.31-32.
[378] See, for example, Argument of CME, p. 21.
[379] 10Tr.31.

There are a number of reasons why it is necessary to consider the details of what has contributed to the revenue sufficiency. Is the cause an isolated or one-time event? Are there other details or matters which need to be considered that are not self-evident from the filings that calculate the revenue sufficiency? Will future forecasts remove the likelihood of the cause repeating?

There are numerous factors which contribute to the revenue sufficiency. Mr. Culbert was cross-examined extensively about the factors, which are summarized below. What becomes clear in reviewing these factors is that each are either a one-time event or the result of variances to forecasts which could have gone either way, but in all instances, the factors are not indications of expected future revenue sufficiencies.

(i) Customer Care/CIS Costs: While Enbridge's total actual O&M costs in 2013 of $415.5 million were only slightly above the Board-approved level of $415.1 million,[380] this was because additional spending pressures were offset by Customer Care/CIS costs which were about $6.2 million under the Board-approved level ($89.4 million versus $83.1 actuals). Without the associated savings, O&M costs would have been higher.

There are two important things to note in relation to the Customer Care/CIS costs.

First, there is no evidence that the difference in CIS/Customer Care costs from Board-approved will continue beyond 2013. The Company was asked about the details of this $6.2 million difference and whether this difference was likely to continue. In its response to Undertaking J10.2, the Company provided a breakdown of the $6.2 million difference between the Board approved and actuals for the Customer Care/CIS costs in 2013. The response demonstrated that the experience of the one historical year in terms of variance to Board approved costs was not indicative of future trends. One future trend that is

[380] Ex.D1-3-1, Table 1 Updated.

known, but does not appear in 2013 results, is the very large increases in Canada Post's charges, which are effective as of March 31, 2014.

Second, the Board-approved Customer Care/CIS costs were established within the EB-2011-0226 Settlement Agreement, which set the amount of recoverable cost per customer through 2018. That Settlement Agreement specifically fixes forecasts of Customer Care/CIS costs, thereby incenting the Company to operate productively but also allocating to the Company the risk of future cost increases, such as the recent almost doubling of postal rates. Enbridge remains at risk for the amounts resulting from the application of the fixed unit cost rates that were agreed to by the parties and approved by the Board in the Settlement Agreement to these customer forecast numbers.[381]

Intervenors, by seeking a base adjustment of $31.2 million, are not only trying to recover the $6.2 million difference noted above but they are also, in effect, asking the Board to amend the Customer Care/CIS Settlement Agreement which did not provide for any sharing or true up of this difference in 2013. Indeed, the proposal by intervenors goes further as it would embed the difference for the balance of the IR term regardless of the fact that there are Board approved budgets for Customer Care/CIS in each of years 2014 through 2018. This is, of course, inappropriate.

(ii) Cost of Capital: The 2013 actual cost of capital was very close to Board-approved, because an increase in the return on equity resulting from a higher rate base[382] was offset by lower than approved debt costs[383]. Enbridge has provided forecasts of all elements of cost of capital for 2014 to 2018 that are based on the most up-to-date information at the time of filing, and Enbridge has indicated that it is open to having ROE and cost of debt parameters updated

[381] 10Tr. 40-41.
[382] 9Tr.20 and 21 and Ex.J1.2, p.7. See also 10Tr.32-38.
[383] 9Tr.17, 18 and 20. See also 10Tr.32-38.

annually within rate adjustment proceedings.[384] Therefore, any differences between Board-approved and actual cost of capital in 2013 should not be expected to have any impact on future years.

(iii) Margin Increase: The largest portion of the 2013 revenue sufficiency relates to a number of items around Enbridge's distribution margin.[385] As explained by Mr. Culbert, these are not items that are expected to be repeated in future years.[386]

A large part of the margin increase resulted from the average number of unlock customers, as well as contract volumes, being higher than included within the Board-approved forecast.[387] It follows that such changes which are outside of the control of the Company should not form the basis of any change to the 2014 base.[388] The Customized IR plan includes an annual rate adjustment proceeding that includes annual updates of the forecast for unlock customers and volumes. There are detailed customer and volume forecasts for 2014 within this application. This, of course, means that the variance in 2013 between Board-approved and Actuals for customer unlocks and contract volumes does not carry forward into subsequent years. Annual forecasts of customer numbers and volumes will be dealt with in the annual rate adjustment proceedings.[389] To make a five-year adjustment now for differences in 2013 customer numbers and volumes would effectively be making a determination that Enbridge will be underforecasting customers and volumes in each future year of the IR term. That is not appropriate.

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[384] See discussion of Cost of Capital, in Section 9 of this Reply Argument.
[385] Ex.J1.2, p. 5. Note that while "increase in gas in storage carrying costs" is listed as a contributor to margin, this item does not contribute to revenue sufficiency, as discussed by Mr. Culbert at 9Tr.28.
[386] 9Tr.27-29 and 10Tr.45-50.
[387] Ex.J1.2, p. 5, items titled "higher number of average unlock customers" and "higher contract demand volumes".
[388] 9Tr.27.
[389] 10Tr.44-45.

A further part of the margin increase relates to fuel cost charges and variances.[390] Essentially, some fuel costs charges were lower than included in the gas supply plan associated with Board-approved 2013 rates. These fuel cost changes do not and never have formed part of the PGVA reference price or mechanism.[391] They are primarily related to the demand side of the equation rather than the price of the commodity.[392] Mr. Culbert confirmed that the Company is at risk for anything that it is demand related, and it is at risk for the forecasting of storage and transportation fuel costs.[393] Clearly, changes in fuel costs in 2013 should not be a basis to adjust base rates within a 5-year IR term, when the Company continues to assume the risk for the forecasting of such costs. As Mr. Culbert advised, the forecast fuel cost charges for each year of the Customized IR term will be part of the Company's gas supply plan, and therefore will be re-forecast each year.[394] The review of the gas supply forecast and the gas supply plan will happen on an annual basis.[395]

Another aspect of the margin increase that relates to the revenue sufficiency is a one-time item for "stale-dated cheques" and other items.[396] As Mr. Culbert explained, there is no reason to believe that the circumstances relevant to this item will repeat in future years.[397]

(iv) Income Taxes: The other main contributor to Enbridge's 2013 revenue sufficiency was income tax expenses that were lower than Board-approved.[398] The differences between Board-approved and actual income tax amounts in 2013 was particular to the circumstances of that year. The major driver of the difference between the actual utility tax calculation and the forecast which

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[390] Ex.J1.2, p. 5, item titled "stale dated cheques and other".
[391] 9Tr.28.
[392] *Ibid*.
[393] *Ibid*.
[394] 10Tr.46-47.
[395] 10Tr.47.
[396] Ex.J1.2, p. 5, item titled "lower transmission and storage related fuel cost charges".
[397] 10Tr.47-49.
[398] Ex.J1.2, p. 5, item titled "Income Tax Expense".

contributes to the 2013 revenue sufficiency is the tax deductions which were higher by $25 million than forecast.[399] Some of the reasons for the change in deductions include the cost of retirements and an increase in some CCA categories because of the increase in capital spending.[400] Timing is also an issue where, for example, some of the removal of cast iron and bare steel mains spilled over into 2013.[401] Such an increase of removal costs in 2013, which are immediately deductible for tax purposes in the year, will not have any similar treatment available for future fiscal years.

Enbridge's Customized IR plan includes detailed forecasts of capital spending, and the associated tax implications of those expenditures, over the IR term. Given that no party has directly challenged the Company's income tax forecasts for 2014 to 2018, it is not appropriate for this to be effected indirectly through a base year adjustment.

Each of the factors referenced above was raised and discussed during cross-examination. It is notable that there is virtually no mention of these factors in the submissions of the parties who argue for a base year adjustment to be made. Enbridge submits that this is because it was recognized that these factors are not matters which indicate future cost decreases and therefore they are not a proper basis to adjust the base rates.

In summary, the evidence establishes that there is no basis for adjusting base rates simply because of a revenue sufficiency generated in 2013, for all of the reasons set out above. The risks which the Company faces in respect of future forecasts are not changed by the results in 2013, many of which relate to factors which either will not or cannot be predicted to continue and do not have an impact beyond 2013 through the Customized IR plan years 2014 through 2018.

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[399] This is demonstrated comparing Ex. J1.2, p. 6, line 14 to Ex.K9.2, p. 6, line 15.
[400] 9Tr.29-30.
[401] 9Tr.30-31.

As a final point, the Company submits that if adjustments are to be made to 2014 base rates to take account of actual 2013 results, then this should include adjustments to take account of the impacts of the Company's actual capital spending in 2013. As explained earlier, Enbridge spent significantly more than the Board-approved amount for capital in 2013 ($442 million versus $387 million). However, to be consistent with the 2013 capital spending amounts agreed upon within the 2013 Settlement Agreement, Enbridge did not include the impact of any of that overspending within its rate base amounts for 2014 and beyond, meaning that the proposed Allowed Revenue amounts are lower than would be the case if actual spending was reflected.[402] In Enbridge's submission, any base year adjustment that takes account of actual results from 2013 must also take this factor into account.

11. Site Restoration Costs

The circumstances giving rise to Enbridge's proposal with regard to Site Restoration Costs (SRC) were outlined in Argument in Chief.[403] In summary, due to the magnitude of the SRC amount that had accumulated as at the time of the 2011 depreciation study carried out by Gannett Fleming (GF), Enbridge asked GF to review the net salvage calculations. As a result of its review, GF recommended that Enbridge use a Constant Dollar Net Salvage (CDNS) approach in the development of net salvage percentages. Based on the application of the CDNS methodology, Enbridge proposes to return $259.8 million to customers by way of a rate rider and to implement lower depreciation rates on a going-forward basis.

In response to Enbridge's proposal, the Board has received an exceedingly wide range of arguments on the subject of SRC. The ideas put forward by others range from the argument that no amount should be refunded to ratepayers[404] to an argument that the entire amount recovered by Enbridge for SRC (in excess of $900 million) should be

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[402] Ex.B2-1-1, p.5.
[403] Argument in Chief, pp. 58-60.
[404] Board Staff Submission, p. 65.

refunded to ratepayers[405] and they include numerous variations on these ideas, such as an argument that contract customers should "receive their refund in a lump sum rather than a longer term rate rider".[406]

Enbridge submits that the widely divergent submissions on the SRC issue have served an important purpose in this case: they have revealed that Enbridge's original proposal actually is a reasonable path for the Board to take that occupies the middle ground among the variety of propositions that have been put to the Board in arguments about SRC. When viewed in comparison to the ideas emerging from other arguments, Enbridge's proposal can be seen as one that reasonably balances the key considerations that bear on the SRC issue.

In addition, Enbridge's proposal is supported by the testimony of its witnesses, including the evidence of Mr. Kennedy, the expert witness from GF. No other witnesses were called to testify on the subject of SRC. Enbridge urges the Board to assess the arguments made by others with careful consideration of the extent to which the ideas, commentary and assertions put forward in arguments have any appropriate evidentiary grounding. Specifically, Enbridge asks the Board to consider whether these ideas, comments and assertions should have been the subject of evidence called specifically to support them, whether they should have been tested during the evidentiary phase of the hearing and, in some instances, whether they should at least have been put to the witnesses so that the Board would hear the responses of the witnesses to them.

As a whole, the arguments on SRC are extensive and Enbridge will not attempt to address every idea, comment or assertion that, in Enbridge's view, should be given little or no weight by the Board. The following, however, are some examples of suppositions and assertions that should not be given weight in the Board's consideration of the SRC issue:

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[405] Final Argument of SEC, p. 88, para. 7.11.4
[406] Final Argument of IGUA, p. 11, para. 46.

(i) Comments have been made about the discount rate used in the CDNS calculation,[407] including an assertion that, if Enbridge's proposal is accepted, the discount rate should be adjusted.[408] The discount rate used in the CDNS calculation is supported by the evidence of GF. There is no evidence to support any other discount rate, including any adjustment to the rate used by GF. Any proposal for a different discount rate should have been the subject of evidence that would have allowed testing of the assumptions and merits of the proposal.

(ii) It is said, in reference to "salvage value" as a negative number representing a net cost at end of life of an asset, that this is not the "original intention of net salvage".[409] There is no evidence in this case as to the "original intention" of bodies such as the Financial Accounting Standards Board (FASB) and there is no evidence explaining how it would even be possible to know the "original intention" of FASB when accounting standards in this area were first developed. But there can be no doubt that net negative salvage is a concept that has been recognized for many decades in many jurisdictions.

(iii) It is said that net negative salvage and Asset Retirement Obligations (ARO) "seek to accomplish the same thing, and in similar ways".[410] ARO accounting under US GAAP deals with terminal or final retirement activity, not replacement activity. In contrast, net negative salvage is included in depreciation rate calculations to recognize the costs of all asset retirement activity, both replacement and terminal or final. As explained by Mr. Kennedy, most regulated utilities cannot determine the timing of final retirement of assets, but recognize that this will not occur

[407] See, for example, Board Staff Submission, pp. 58-62.
[408] Final Argument of SEC, p. 74, para. 7.5.16.
[409] Final Argument of SEC, p. 65, para. 7.2.6.
[410] Final Argument of SEC, p. 68, para. 7.3.4.

until after a number of generations of replacements.[411] There is no evidence in this proceeding, and in fact it is not the case, that the rules and procedures of ARO accounting apply in respect of the costs of asset removal in all circumstances.

(iv) It is said that, in the absence of rate regulation, costs for site restoration would be charged to earnings and the key exception to the basic rule arises where a regulator "requires" the regulated entity to set up a reserve for future costs.[412] It is also said that the US GAAP accounting rule remains and, unless the Board makes an "inconsistent determination", Enbridge must expense removal and site restoration costs.[413] The accounting standards do not indicate that a regulator must "require" a regulated entity to set up a reserve; it most certainly is sufficient if the regulator "allows" a reserve. And there is no need for an "inconsistent" determination by the Board; there is nothing "inconsistent" about a decision of the Board to continue the approach that for decades it has approved for Enbridge.

(v) Similarly, it is said that, now that US GAAP has been adopted, the question should be whether there is good regulatory reason for the Board to "overrule" the normal accounting rule.[414] The Board does not need to "overrule" anything. The Board need only continue to approve the common practice that has been the longstanding approach for Enbridge.

(vi) An interpretation of the practice of the National Energy Board (NEB) has been offered, specifically, that the NEB has "mandated that removal/replacement costs be treated as current expenses".[415] This interpretation is not correct. Costs of asset retirements by NEB-regulated

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[411] 9Tr.45.
[412] Final Argument of SEC, p. 69, para. 7.4.3.
[413] Final Argument of SEC, pp. 75-76, para. 7.6.2.
[414] Final Argument of SEC, p. 76, para. 7.6.7. See also para. 7.6.8 on the same page.
[415] Final Argument of SEC, p. 85, para. 7.9.12.

entities, other than costs in abandonment situations, are included as net negative salvage costs in depreciation calculations.

As is apparent from the submissions of SEC[416] and CME,[417] changes to the discount rate used in the CDNS calculation can have a significant impact on the outcome of the calculation at any particular point in time. Thus, it is clear that the use of more extreme values for the discount rate create a potential for large and significant swings in SRC funding requirements from case to case. As for the discount rate used by Mr. Kennedy, his testimony was as follows:

> …I want to be clear. It wasn't a number that I pulled out of my head. It is a number that has basis within accounting theory in this country and in fact in regulatory theory within this country, as use as an appropriate discount factor. … It is a number with basis, and in fact is widely used within the accounting circles in this country.[418]

Mr. Kennedy also explained in his testimony that the recommendation made by GF, upon which Enbridge's proposed refund is based, resulted from an extensive amount of work by GF. Mr. Kennedy said that his advice to the Board, and to all regulators, is that conclusions should be reached from "well-thought-out correctly vetted studies".[419]

Enbridge submits that the ideas presented in argument about a larger refund than that recommended by GF, including the proposal that all of the SRC reserve be returned to customers, are anything but "well-thought-out correctly vetted studies". There has been no evidence called to support these ideas and they have not been subjected to the scrutiny and testing that would have occurred if evidence had been presented to support them.

Board Staff notes in its argument that the Board has approved the recovery of net negative salvage as a component of depreciation since at least 1959.[420] Board Staff

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[416] Final Argument of SEC, p. 74, para. 7.5.14.
[417] Argument of CME, p. 11, para. 38.
[418] 9Tr.63.
[419] 9Tr.174-175.
[420] Board Staff Submission, p. 66.

says specifically that it does not challenge the approval to collect SRC from ratepayers and that it does not oppose the use of the CDNS methodology.[421]

No-one has cast any doubt on Mr. Kennedy's evidence that, in the specific circumstances of Enbridge, use of the "traditional" method has resulted in net salvage percentages that are "generically", "systematically" and "substantially" higher than the comparators used by GF.[422] The question, then, is what, if anything, should be done about the SRC reserve that has accumulated. It is on this question in particular that the Board has received divergent ideas.

On the one hand, some parties argue for a greater refund than that recommended by GF, including even the elimination of the SRC reserve. But, for all the reasons set out above, these arguments do not have an appropriate evidentiary grounding. On the other hand, Board Staff submits that the amount of SRC to be recovered "in the test period" should be the total amount to be spent.[423] This approach would, in effect, leave any growth or refund of a surplus amount of SRC recovery on hold through to the end of 2018. But, with all respect to Board Staff, since GF has concluded that Enbridge's net salvage percentages are systematically higher than the comparators and GF has provided an expert opinion and report supporting a refund, it is difficult to see why the growth or refund of a surplus amount should be put on hold without any refund to customers.

Enbridge's proposal lies in the middle ground between these two positions. And of course, it is supported by the evidence, specifically, the evidence of GF and Enbridge's witnesses. Mr. Kennedy indicated that, after much analysis by GF, he is "very comfortable" with the result of the proposal.[424] Enbridge's proposal is based on a discount rate that is widely used in both an accounting context and a regulatory context and it avoids the use of more extreme values that could lead to large swings in SRC

[421] Board Staff Submission, pp. 65 and 66.
[422] 9Tr.175.
[423] Board Staff Submission, p. 66.
[424] 9Tr.174.

funding requirements. There will be a true-up when the next Enbridge depreciation study is completed – probably 2017 or 2018[425] – and Mr. Kennedy expects that any future variations will not be of the magnitude that results from the change to the CDNS methodology, but will be more in line with those that occur whenever a full depreciation study is performed.[426] And Enbridge's proposal has both a rate mitigation and a bill mitigation effect.

A number of parties found it important to emphasize that the SRC issue is distinct from issues relating to Enbridge's Customized IR plan.[427] Enbridge has indeed repeatedly confirmed that the SRC proposal stands on its own and is not specifically tied to a particular rate regulation model.[428] Energy Probe says, though, that Enbridge has tried to make the proceeding more difficult than it needed to be by trying to "combine" the SRC issue with the Customized IR plan.[429]

As for the SRC issue being combined with the Customized IR plan, parties still seem to be missing a critical point. In order to analyze and present the implications of the SRC proposal, Enbridge must consider the effects of the proposal in a number of areas, including cost of capital, depreciation and tax changes. Enbridge has been able to model these effects in areas such as cost of capital, depreciation and tax changes because it can use, and has used, the forecasts of rate base that it developed for the purposes of the Customized IR plan. An I Minus X model, for example, would not include forecasts of rate base that Enbridge would be able to use to analyze and present the effects of the SRC proposal.

In other words, Energy Probe is wrong when it says that Enbridge has tried to make the proceeding more difficult by trying to combine the SRC issue with the Customized IR plan. Rather, the advantage of the Customized IR plan in this context is that it includes forecasts of rate base that have allowed Enbridge to model the implications of the SRC

[425] 9Tr.81-82.
[426] 9Tr.214.
[427] See, for example, Final Argument of CCC, p. 3 and Final Argument of Energy Probe, p. 2.
[428] 2Tr.63-64; 2Tr.151; 9Tr.195-196; Argument in Chief, pp. 16-17.
[429] Final Argument of Energy Probe, p. 2.

proposal and Enbridge has used those forecasts for precisely that purpose. The proceeding would have been far more "difficult" if Enbridge had been forced to present and explain the implications of the SRC proposal in the context of an I Minus X plan.[430]

Given that parties seem to be missing this critical point (even though it was addressed in Argument in Chief),[431] Enbridge believes that a related point should be emphasized. As stated, the SRC proposal has been modelled relative to the forecasts of rate base that have been provided in support of the Customized IR Model. To the extent that the forecasts of rate base change as a result of any aspect of the Board's decision in this proceeding, then the effect of such change will flow through to alter the implications of the SRC proposal.

Finally on the SRC subject, certain parties suggest that the Board should hold a generic proceeding.[432] It would seem, though, that an essential requirement for a generic proceeding is a generic issue. There is no evidence in this case of a live issue with respect to SRC involving any other utility regulated by the Board and no example of a live issue involving another utility is given in intervenor submissions. Enbridge understands that Union Gas recovers SRC, but there is no reason to expect that Union Gas will be addressing an SRC issue in the near future or at all, considering that Union is in the first year of its five year IR plan and no such issue is evident within that plan.

For all of these reasons, Enbridge reiterates its submission that the Board should approve the SRC proposal made by Enbridge.

[430] Mr. Culbert testified that, without Allowed Revenue calculations using rate base forecasts, he would have been able to provide the impact of the SRC proposal on an after-the-fact basis using actual rate base, but he would not have been able to provide the impact of the proposal in this proceeding for ratemaking purposes, because rates would not be set from rate base projections: 9Tr.151-152.
[431] Argument in Chief, pages 16-18.
[432] See Argument of CME, pp, 12-13, paras. 40-44 and Final Argument of SEC, pp. 85-86, paras. 7.9.13 to 7.9.15.

12. 2014 to 2018 Deferral and Variance Accounts

The list of deferral and variance accounts that Enbridge seeks to have approved for the Customized IR term is set out in evidence.[433] The fact that only five of those accounts have attracted widespread comment from intervenors[434] stands in contrast to the common complaint in intervenor arguments that Enbridge's deferral and variance account requests improperly shift the risk/reward balance in favour of the utility.[435] Were that a real concern, one would expect to see many more intervenor complaints raised about the proposed accounts. Indeed, one party (FRPO) proposes that the Company add to the number of proposed accounts, by maintaining an account that the Company seeks to terminate.[436] The fact that Dr. Kaufmann indicates that he does not oppose the proposed variance accounts[437], with only two exceptions[438], also signals that there is no real concern that the proposed deferral and variance accounts improperly shift risk away from Enbridge. The two exceptions that Dr. Kaufmann points to are the 2017/2018 variance accounts related to replacement mains and relocations. Dr. Kaufmann did concede, however, that the subject matter of such accounts could be addressed through a Y Factor approach in a different type of IR model[439] (such that there would be a pass-through treatment of the costs). In sum, therefore, Enbridge submits that the positions actually taken by intervenors in relation to deferral and variance accounts do not support their contention of improper shifting of risk.

a. Continuation of Existing Accounts

For the most part, there are no concerns raised with Enbridge's proposal to continue existing accounts.

433 Ex.D1-8-1, pp. 2-3. Ex.J2.1 sets out which accounts will be in place each year of the term.
434 OHCVA, TSDA, GTAPVA, RLMVA and RPMVA.
435 See, for example, Final Argument of CCC, p. 20 and Final Argument of Energy Probe, p. 4.
436 This is discussed below, in relation to the DDCTDA.
437 Ex.L-1-2, p. 26.
438 3Tr.143-144.
439 4Tr.139-141.

The main exception is the Ontario Hearings Cost Variance Account (OHCVA). Many parties argued that the OHCVA should be discontinued, primarily on the basis that other utilities do not have a similar account.[440] Within Argument in Chief, Enbridge set out the reasons why this account is appropriate, and the manner in which it actually increases the Company's transparency and accountability for regulatory costs.[441] What becomes even clearer through intervenor submissions in this case is that Enbridge has little opportunity to control its regulatory costs. In the various arguments submitted, parties have argued for new proceedings and/or Enbridge consultatives to address site restoration costs, RCAM and Rate 125 design, and increased reporting and stakeholder meetings to address gas supply, capital spending, overall operations/plans and productivity. It is very difficult, if not impossible, to accurately predict the associated costs. The OHCVA protects all parties from over- and under-spending and has been in place for many years, during which other utilities did not have such an account, presumably because of their own particular circumstances. During Enbridge's 1st Generation IR term, the OHCVA (which all stakeholders supported) resulted in a refund to ratepayers in some years, and a credit to the Company in other years.[442] Since the last years when the account has been approved (in 2008, for the 1st Generation IR term, and in 2013), there has been no change in circumstances in relation to the regulatory costs that are recorded within the OHCVA. In Enbridge's view, denying the continued existence of the OHCVA at this time, in advance of a second IR term, upsets the intended balancing performance of the account in relation to the cost of regulation in Ontario which is clearly beyond Enbridge's influence or control.

Additionally, FRPO proposes that the Design Day Criteria Transportation Deferral Account (DDCTDA) should be maintained beyond 2014, in order to maintain transparency in Gas Supply.[443] Enbridge disagrees. The purpose of the DDCTDA was to record unutilized demand charges (UDC) related to the phase-in of new Peak Gas

[440] See, for example, Board Staff Submission, p. 53.
[441] Argument in Chief, pp. 74-75.
[442] Ex.I.A11.EGDI.SEC.57.
[443] Final Argument of FRPO, pp. 21-22.

Design Day Criteria in 2013 and 2014.[444] That phase-in will be complete after 2014. Thereafter, UDC costs can all be addressed through the Unabsorbed Demand Costs Deferral Account (UDCDA). Indeed, it would not be possible to determine in the future what parts of UDC relate to historic changes in design day, and what relates to the need to procure long haul FT transport rather than short haul transport. FRPO points to uncertainty that currently exists over developments with infrastructure and NEB decisions pertaining to TransCanada PipeLines (TCPL) and future TCPL tolls as a reason not to determine at this time to discontinue the DDCTDA for 2015.[445] Enbridge disagrees. One likely outcome of these developments is that Enbridge will have significantly less long haul FT capacity once the GTA Project facilities are in service, meaning that UDC will be a much less meaningful issue. In any event, Enbridge notes that it is open for the Company or FRPO to request the continuation of the DDCTDA within the 2015 rate adjustment proceeding, at which point there could be some evidence or record upon which to make a decision. FRPO itself seemed to acknowledge this in its examination of Enbridge's gas supply panel. When Enbridge's witnesses indicated that the Company plans to address all UDC costs within the UDCDA in 2015, FRPO's counsel stated "we'll save that debate for another day".[446]

b. Existing Accounts which Enbridge seeks to Change

In relation to the existing accounts for which Enbridge seeks changes in terms or scope, the only one that has attracted attention is the Transactional Services Deferral Account (TSDA). Enbridge proposes to change the TSDA such that while the Company will continue to credit $12 million to revenue requirement for anticipated TS revenues, Enbridge will no longer have to absorb the cost consequences of the ratepayer share of actual TS earnings being less than that amount. Currently Enbridge includes a credit of $12 million in revenue requirement related to an anticipated ratepayer share of TS net revenues, with a guarantee of $8 million in ratepayer share. In the event that the

[444] Ex.D1-8-1, pp. 21-22. See also 8Tr.13-14.
[445] Final Argument of FRPO, pp. 21-22; See also Ex.I.E36.EGDI.EP.36 and 8Tr.14-18.
[446] 8Tr.23.

ratepayer share of TS net revenues exceeds $12 million, these excess amounts are credited to ratepayers. If the ratepayer share of TS net revenues is less than $12 million, Enbridge is credited with the difference between the actual ratepayer share of TS net revenues and $12 million, up to a maximum credit of $4 million. In light of current and expected changes in TCPL's tolls and services, which will reduce TS opportunities, the Company does not believe that the current approach remains appropriate.[447] Instead, while Enbridge agrees to continue with the $12 million annual credit, and the 90/10 sharing of TS revenues in favour of ratepayers, Enbridge believes that it is appropriate to remove the guarantee, such that the Company will not have to absorb TS under-earning relative to the $12 million that is included as a credit to rates.

The Company disagrees with the suggestion that the credit to rates should be increased, based on past TS performance.[448] As confirmed by FRPO, this proposal fails to take into account the recent TCPL changes, and the changes in the services taken by Enbridge, each of which may reduce TS opportunities.[449] It also fails to account for other recent and pending developments, described in some detail below.

The defining elements of TS transactions are that the optimization opportunity be unplanned, temporarily surplus and involve a third party.[450] These requirements are in place to ensure that the Company's focus remains on meeting the operational needs of its customers reliably first and only then seek financial optimization for its customers.

As discussed in the 2012 ESM proceeding, a very large proportion of Enbridge's TS revenues in recent years has been driven by opportunities related to TCPL's FT-RAM program. That program is now discontinued, and those TS revenues are no longer available.[451]

[447] Ex.C1-3-1 and Ex.D1-8-1, pp. 8-9.
[448] Board Staff Submission, p. 54.
[449] Final Argument of FRPO, p. 25.
[450] These are the elements which Enbridge submits must be present in order for a transaction to qualify as a TS transaction, as acknowledged in the Board's decision in Enbridge's 2013 ESM proceeding (EB-2013-0046, Decision and Order dated February 6, 2014, p. 5).
[451] 11Tr.43.

Further, based on TCPL's ability to determine the price charged for discretionary services, many market participants are now in the same circumstance as Enbridge, in that they hold FT capacity which will go unused at certain times of the year. The result is that the amount of capacity available for assignment or release in the marketplace is high, and TS opportunities are more uncertain and less valuable. The uncertainty as to TS opportunities is exacerbated by the fact that Enbridge itself will hold what may be significant amounts of TCPL FT capacity available to release into the marketplace to reduce possible UDC charges to be borne by ratepayers.[452] The release of that capacity will reduce opportunities for TS transactions.

Additionally, it can be seen within Enbridge's historic TS results that the net revenues obtained from storage transactions continue to decline.[453] In 2013, the storage-related TS revenues were around one-third of the level only three years earlier. There is no evidence (or expectation) that revenues from storage-related TS transactions will rebound.

Finally, the implementation of the GTA project will change Enbridge's transportation contracting, with a declined reliance on TCPL long-haul service.[454] This too is expected to take away some of the existing TS opportunities, and make it more difficult to maintain current or historic levels of TS revenues.

In these circumstances, now is not the time to increase the level of TS revenues included in rates beyond the current $12 million amount. Moreover, imposing a higher TS guarantee in light of the declining set of TS opportunities as described above is punitive for the Company's shareholder and is inconsistent with the fact that the Company's primary responsibility is to use its gas supply portfolio to meet the operational needs of its customers safely.

[452] Ex.I.E36.EGDI.EP.36.
[453] Ex.I.E36.EGDI.EP.36
[454] As noted in the Decision and Order in the GTA Proceeding (EB-2012-0451), dated January 30, 2014, at p. 50.

Instead, the circumstances described above support the Company's proposal to remove the $8 million "guarantee" from the TSDA, and demonstrate why it is in no way appropriate to increase the level of that guarantee. The Company's proposal, which still provides ratepayers with 90% of the net revenues from TS transactions, effects a better balance of risk and reward for all parties.

c. Proposed New Accounts

Stakeholders did have comments in relation to several of Enbridge's proposed new deferral and variance accounts.[455]

First, stakeholders support the creation of the Greenhouse Gas Emissions Impact Deferral Account (GGEIDA).[456]

Second, while there is no opposition to the creation of the Customer Care Services Procurement Deferral Account (CCSPDA), some parties suggested that the amount to be recorded within that account be capped at $5 million.[457] Enbridge accepts that limitation.

Third, there were comments from four parties about the proposed Greater Toronto Area Project Variance Account (GTAPVA).

The GTAPVA allows for tracking of differences in costs from what is contained in Allowed Revenues.[458] Amounts to be recorded may result from costs that differ from forecast, and may also result from differences in the in-service date for the project. This protects both ratepayers and the Company. For example, if circumstances lead to a later in-service date from what is forecast, then there will be credit to ratepayers to recognize the fact that Allowed Revenue amounts reflect the earlier in-service date. On the other hand, if costs are more than forecast, then Enbridge would be permitted to

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[455] Discussion of the SRC issue which relates to, among other things, whether the proposed Constant Dollar Net Salvage Adjustment Deferral Account is required, is set out earlier in this Reply Argument.
[456] Final Argument of Energy Probe, p. 27, and Submissions of BOMA, p. 43.
[457] For example, Final Argument of Energy Probe, p.27.
[458] The GTAPVA is described at Ex.D1-8-2.

record the overages in the GTAPVA, but could not recover the balance until having successfully completed a prudence review before the Board.

Board Staff[459] and CCC[460] support the creation of the GTAPVA. Board Staff suggests, however, that it should be capped, perhaps at a 10% overage level. Alternately, Board Staff suggests that the Board could emphasize that any excess costs over and above the forecast will be examined in the next rate application after completion of the project. Enbridge does not believe that it is fair to pre-emptively limit the amount that can be recorded within the GTAPVA. For example, costs may be recorded that relate to changes in project timing that are entirely out of the Company's control.[461] The Company does acknowledge and accept, though, that any overages in project costs will be subject to scrutiny at the time when the balance within the GTAPVA is presented for clearance.

Energy Probe[462] and BOMA[463] object to the creation of the GTAPVA, stating that Enbridge should take the risk for capital expenditures within the Customized IR model. Energy Probe states that there is no evidence that the risk of the forecast for the GTA project is any different from the risk of forecast for core capital expenditures. The Company submits that it is a fair conclusion that the risks associated with the most costly single project in its history are indeed greater than other risks.[464]

As a final point, the Company notes that within the combined LTC proceeding that considered Enbridge's GTA project and Union Gas facilities requests, Union Gas received approval of a variance account to track variances from the $219 million cost estimate for that project.[465] Enbridge seeks similar approval in this case.

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[459] Board Staff Submission, p. 53.
[460] Final Argument of CCC, p. 20.
[461] These cost differences could be a significant credit to ratepayers if the project is delayed beyond the assumed in-service date that has been used to calculate Allowed Revenue amounts.
[462] Final Argument of Energy Probe, p. 26.
[463] Submissions of BOMA, p. 42.
[464] See Ex.D1-8-2, p.3.
[465] EB-2012-0433, Decision and Order dated January 30, 2014, p. 60.

Fourth, BOMA indicates the proposed new Greater Toronto Area Incremental Transmission Capital Revenue Requirement Deferral Account (GTAITCRRDA) should be expanded beyond what is proposed. Enbridge has stated that the account will be required only if there are no transportation customers at the time that Segment A of the GTA project is put into service. BOMA states that the account should also address the scenario where there are not a reasonable number of shippers on Segment A to cover the transmission portion of the revenue requirement.[466] There is no case where this situation could occur, as the Rate 332 demand charge will be designed to recover 60% of the revenue requirement for Segment A, no matter how many Rate 332 transportation customers take the service. Further, the response to the open season suggests that subscribing capacity on Rate 332 service will not be an issue.

Finally, there is opposition from Board Staff[467] and CCC[468] to the two new accounts (the RPMVA and RLMVA) related to Enbridge's capital costs from relocations and replacement mains activity in the last two years of the Customized IR term. As explained in Argument in Chief[469], these accounts arise from Enbridge's proposal to set its 2017 and 2018 capital budgets at the 2016 level, without any allowance for potential new costs during those years. As indicated in testimony, it will be very challenging for the Company to maintain its spending at that level.[470] This is particularly true in the case of relocations, which are situations where a third party public authority requires Enbridge to move its existing pipes to accommodate work projects, and in the case of mains replacement requirements identified through pipeline inspection activities. In this regard, the Company rejects the suggestion made by Dr. Kaufmann, reproduced in Board Staff Submissions, that the Company's replacement pattern and reinforcement expenditures are entirely within its control.[471] As explained in evidence, the mains replacements resulting from pipeline inspection activities and relocations requirements

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[466] Submissions of BOMA, p. 44.
[467] Board Staff Submission, p. 53.
[468] Final Argument of CCC, p. 20.
[469] Argument in Chief, pp. 75-76.
[470] 4Tr.176 and 191.
[471] Board Staff Submission, p. 33.

are both items that are not readily controllable by the Company.[472] While Enbridge has indicated that it is prepared to take the risk of accommodating the cost of these activities within its filed budgets from 2014 to 2016, the risk associated with these areas for 2017 and 2018 is too extraordinary.[473] Rather than proposing higher Allowed Revenue amounts associated with spending in these areas for 2017 and 2018, the Company has instead proposed an approach whereby variance account treatment is available if a certain level of spending over the amount included in Allowed Revenue is required.[474] Therefore, rather than including reasonable costs for incremental activities in these areas for 2017 and 2018, the Company opted to keep its budgets flat, but to include a measure of variance account coverage.

Having reviewed the stakeholder submissions about these accounts, the Company acknowledges their perspective that the accounts unduly mitigate risks. That is not Enbridge's intention with these accounts. They are meant to balance the fact that Enbridge did not increase its 2017 and 2018 capital budgets against potential uncontrollable costs that may arise. In order to move that balance further in favour of ratepayers, Enbridge proposes to change the eligibility level for each account from a revenue requirement of $1.5 million to $5 million. This will mean that Enbridge will not be able to recover any overspending unless the costs for either relocations or mains replacements in either 2017 or 2018 are around $50 million higher[475] than what is included in the base budgets for those items.[476] Even then, amounts recorded in the accounts will be subject to review before clearance. In the result, Enbridge will have to absorb spending requirements that are very substantially above what is included within Allowed Revenue in these uncontrollable areas before even being eligible for the RPMVA or RLMVA.

[472] Ex.B2-1-1, pp. 41-42.
[473] 6Tr. 70-71.
[474] The proposed variance accounts, the RLMVA and the RPMVA, are described at Ex. D1-8-6.
[475] This is a high-level estimate of the capital spending that would be associated with a $5 million revenue requirement.
[476] 5Tr.166.

13. Other Issues

Within intervenor submissions, there are a number of items raised that are not directly relevant to the topics already discussed within this Reply Argument. Set out below are the Company's responses to several of those items.

a. Breach of Settlement Conference Confidentiality

IGUA's argument opens with a statement of IGUA's view that "much of the time" during the Settlement Conference in this proceeding was "preoccupied" with a particular area of discussion. IGUA baldly asserts that "[i]t does not breach any confidences" for IGUA to state its view of discussions that took place during the Settlement Conference.[477]

Of course, it is a breach of confidence for IGUA to state in argument its view of the discussions that took place during the Settlement Conference. The Board's Settlement Conference Guidelines could not be more clear that admissions, concessions, offers to settle and "related discussions" are to be treated as confidential by everyone who attends a settlement conference and that "any such information" must not be revealed outside the conference.[478]

The breach of confidence is all the worse in this case, first, because IGUA's statement about discussions that occurred during the Settlement Conference is not accurate and, second, because IGUA goes even further and implies that Enbridge is to be blamed for the outcome of the Settlement Conference.[479]

Obviously, Enbridge is limited in its ability to respond to IGUA's statement without itself making comments about the Settlement Conference that would breach the

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[477] Final Argument of IGUA, p. 1, para. 3.
[478] Ontario Energy Board Settlement Conference Guidelines, p. 4.
[479] IGUA's inaccurate portrayal of the Settlement Conference is that the manner in which Enbridge presented the SRC proposal caused parties to be "preoccupied" and that this was "at the expense of discussions on other important aspects of the application". IGUA's assertion in this regard that Enbridge needlessly "conflated" the SRC proposal with the presentation of revenue requirement/rates is simply wrong: see the discussion of the SRC proposal, above.

confidentiality of settlement discussions. Suffice it to say that the Board should completely disregard IGUA's inaccurate statement about the Settlement Conference in this proceeding and the unfounded attempt by IGUA to ascribe blame for the outcome of the Settlement Conference. IGUA's submissions about the Settlement Conference have added no value to the arguments in this case and are, to put it mildly, less than constructive, insofar as the Board's consideration of Enbridge's application is concerned.

b. New Heating Degree Day Methodology for Enbridge's Central Region

The Company has proposed the continuation of the Degree Day methodology used for the purposes of its 2013 rates proceeding for each of the Niagara and Eastern regions. It is proposing a change to a hybrid methodology for the Central operating region. Stated succinctly, this hybrid methodology is an averaging of the two most reliable methodologies, being the 20-year trend and the 10-year moving average. As noted in the pre-filed evidence, these trends were ranked 1 and 2 respectively for the period 1990 through 2012. [480]

Energy Probe expresses support for the framework established by the Board to select Degree Day methodology.[481] Energy Probe then goes on to accept the hybrid methodology proposed by Enbridge for the Central region in this proceeding noting that on the basis of the evidence, it is "demonstrably better". Energy Probe also accepted the continued use of the Degree Day methodologies proposed for the Niagara and Eastern regions. BOMA adopted Energy Probe's submissions in respect of the Degree Day methodology.[482]

The only other intervenor that commented on Degree Day methodology is SEC, which did not criticize what the Company has proposed but rather suggested that a change to

[480] Ex.C2-1-2, p.4, Table 2.
[481] Final Argument of Energy Probe, pp. 45-46.
[482] BOMA Argument, p.51.

the Degree Day methodology be deferred until the next rebasing.[483] Enbridge sees no reason why an improved methodology that is to the benefit of both ratepayers and the Company should not be employed at the earliest possible time. Enbridge further notes that a change to the Degree Day methodology in 2014 was specifically contemplated by the language of the Complete Settlement at Issue C3 of the Enbridge 2013 rates case where it was agreed that no party would raise any procedural objection if Enbridge sought approval of a different Degree Day methodology in this Application.[484] Accordingly, there is express intervenor support for the Degree Day methodologies proposed by Enbridge and no argument or criticism of the methodologies proposed nor of the timing of the request.

c. Rate 125

(i) Overview

Enbridge is not proposing any changes to its Board-approved cost allocation methodology for the 2014 test year.[485] In subsequent years under Enbridge's proposed Customized IR plan, either Enbridge or other parties can address cost allocation issues (and changes to rates) during annual rate adjustment proceedings.

In its Argument APPrO recommends that Enbridge's cost allocation methodology be refined in two ways, both of which would reduce the level of allocated costs to Rate 125 and increase the costs allocated to the other rate classes.

First, APPrO proposes that the cost of the Extra High Pressure (XHP) system[486] (also referred to in evidence as the Transmission Pressure (TP) system) should be further

[483] Final Argument of SEC, p. 47.
[484] Settlement Agreement, EB-2011-0354, Ex.N1-1-1, pp.15-16.
[485] Ex.G1-1-1, p.1.
[486] The Company's XHP system consists of pipelines of any size which operate at a pressure greater than 1,207 kPa (175 psi). The XHP system is used to move gas from upstream transportation pipelines to the rest of the distribution grid. The associated XHP capacity costs are allocated to the rate classes based on the contribution of each rate class to the peak demand day. This is shown at Ex.G2-6-3, p.1, line 2.1, and the corresponding allocation percentages are shown on Page 2 at Line 2.1. See also Ex.I.C30.EGDI.APPrO.7.

broken down into those assets and expenses that can reasonably serve Rate 125 and the rest of the assets that cannot reasonably serve Rate 125 customers. This is referred to as the "Over-Allocation Issue".

APPrO recommends the following:

- excluding the costs of XHP pipelines smaller than 12" diameter from being allocated to Rate 125 customers;[487] and
- no change to the Delivery Demand TP allocator once XHP pipelines smaller than 12" diameter be removed from the XHP system costs to be allocated to Rate 125 customers.[488]

APPrO's second proposal relates to what it calls the "Double Counting Issue". Essentially, APPrO alleges that Rate 125 customers pay to maintain existing excess capacity on the distribution system when they are connected, and should not have to pay for any future excess capacity that is created.

APPrO proposes that Enbridge should be required to conduct further study of the so-called "Double Counting Issue", and provide the Board and intervenors with a report in 2015, including an assessment of proposed solutions to remedy the alleged issues through the 2016 rate adjustment application.[489]

Part of APPrO's submissions focus on "the deal" that they say exists for Rate 125 customers. The implication is that raising rates for this one rate class somehow violates their special "deal".[490] While Enbridge acknowledges that Rate 125 for directly connected customers was designed to be by-pass competitive, the Company submits that there is nothing to suggest that this is not still the case. As discussed in testimony, Rate 125 delivery charges are already (and will continue to be) considerably lower than

[487] APPrO Written Submissions, pp. 10-11.
[488] APPrO Written Submissions, pp. 23-26.
[489] APPrO Written Submissions, p. 11.
[490] APPrO Written Submissions, pp. 17-19.

other rates, meaning that Rate 125 customers pay much less than they would otherwise pay using other rates.[491] APPrO proposes to further lower the relative rates of Rate 125 customers. The combined impact of APPrO's first recommendation would be to allocate costs of approximately $2.8 million per year away from Rate 125, and onto other rate classes.[492] The total impact on other rates classes of around $14 million (over the five year IR term) is not insignificant. According to APPrO, the impact of the second recommendation is not known.[493]

Enbridge takes issue with APPrO's statement that it is "counterintuitive" that the Company addressed APPrO's position within evidence in chief at the hearing, but did not do so in Argument in Chief.[494] At the time that Enbridge witnesses began their testimony, they believed that APPrO would be advocating for the cost allocation changes set out in the Elenchus report. Through cross-examination of the Enbridge[495] and Elenchus[496] witnesses it became clear that might not be the case. Consequently, Enbridge chose to wait for the argument submission from APPrO to address their position, rather than speculating. APPrO's Written Submissions confirm that APPrO's proposals differ from what is set out in the Elenchus report. First, the size of the pipelines that APPrO says should be allocated away from Rate 125 now include those that are 6" and 8" in diameter. Second, APPrO has not adopted either of Elenchus' recommendations to address the so-called "Double Counting Issue".

In a letter filed April 9, 2014, the Ontario Power Authority notes that increases in Rate 125 "may" result in increases to the price of electricity to Ontario residents.[497] A similar warning is provided in APPrO's submissions (increases in Rate 125 "may" result in increases to the price of electricity).[498] In response, Enbridge submits that the entire

[491] 11Tr.92-94.
[492] APPrO Written Submissions, pp. 22-23.
[493] APPrO Written Submissions, p. 30.
[494] APPrO Written Submissions, p. 4.
[495] 11Tr.13.
[496] 11Tr.85-86.
[497] http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/433232/view/OPA_ltr%20Comment_EGDI_20140409.PDF
[498] APPrO Written Submissions, p. 4.

rate class Rate 125 delivery charges (which total around $10.8 million in 2014[499] for 5 customers) represent a very small part of the total delivered costs of gas for these gas-fired generators. Enbridge asked an Interrogatory to APPrO/Elenchus to identify what proportion of the overall delivered gas charges for a Rate 125 customer are represented by Rate 125 delivery charges, but Elenchus declined to provide the requested information.[500] A review of sample customer bills filed in this case[501] shows that the proportion of the bill represented by delivery charges (i.e. customer plus distribution charges) versus the total bill decreases with the size of the customer. Rate 125 customers are among Enbridge's largest customers and Rate 125 delivery charges are considerably lower than on other Enbridge's rates. Hence, the delivery charges would represent a small part of their total gas costs. Moreover, Enbridge notes that APPrO's proposal simply shifts costs to other rate classes, meaning that energy costs on the whole are not changed.

Enbridge does not agree with the APPrO proposals. Details are set out below. Board Staff[502] and Energy Probe[503] also object to APPrO's proposals. No party indicated support for APPrO's proposals.

(ii) <u>Enbridge does not support APPrO's proposals</u>

A main reason Enbridge does not support APPrO's proposals is because they look at isolated cost elements (I.e. specific investments), which is inconsistent with postage stamp rate making. The Company's rates are designed to recover the test year revenue requirement of an integrated system. The use of postage stamp cost allocation and rate making is supported by the costing of each service at the customer class average. This approach to setting rates does not differentiate between specific investments or the mix of investment vintages. Enbridge's Board-approved cost

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[499] Ex.H2-1-1.
[500] Ex.I.C30.APPrO.EGDI.2.
[501] Ex.H2-7-1.
[502] Board Staff Submission, p. 69.
[503] Final Argument of Energy Probe, p.41.

allocation methodology appropriately and sufficiently determines the relative cost differences between customer classes.

Each customer or a group of customers could argue that they cause less costs than another customer or a group of customers. However, the basic goal of cost allocation is to determine the relative differences in costs to provide service to the various customer classes in order to act as a guide to rate design. The outcome of the cost allocation study is not a precise measurement of the actual cost to serve a certain customer class, and does not represent the cost to serve any particular customer.

This point was stressed by Mr. Kacicnik in his opening remarks:

> But the principle of postage-stamp rates goes well beyond the issue of location. It is a key principle of postage-stamp ratemaking that services provided to customers are costed at average cost, average cost basis. For example, Enbridge is a mature utility established in 1848. We have pipes of all kinds of ages within our network.
>
> Customers who are served through the segments of the network that are older, those customers have a lower cost to serve because those pipes will be heavily depreciated or almost fully depreciated. Customers who are served through the newer parts of the network have higher costs to serve, because those pipes are newer and haven't been depreciated. Now, through postage-stamp ratemaking all customers share in the mix of investment vintages. We don't differentiate based on that. In fact, every customer on the system has a somewhat different cost to serve because it's a function when they would be attached to the system, their location, their load profile, and their load factor, and so on.
>
> So given these complexities of the gas distribution network, the outcome of the cost allocation study is then the best representation of the annual cost to provide service to customers using an approved set of principles and conventions.[504]

In testimony, Mr. Kacicnik confirmed that classifying the distribution network in distinct pressure categories (TP, HP and LP) reflects cost causality:

[504] 11Tr.5.

> MR. VELLONE: And it's my understanding that Enbridge distinguishes in its cost allocation methodology between TP capacity on the one hand and HP and LP capacity on the other; is that correct?
>
> MR. KACICNIK: Yes, it is.
>
> MR. VELLONE: And I just want to explore a little bit the reason why Enbridge is proposing such a distinction, and my question for you is this: Is the distinction between TP capacity pipelines and those lower-capacity pipes driven at least in part by an attempt by Enbridge to better reflect cost causality principles?
>
> MR. KACICNIK: Yes, that's correct.[505]

Such a Board-approved pressure classification of the Company's gas distribution network is based on the fact that as the gas flows through the network it typically would flow first through the XHP system, then the pressure is reduced to the HP level and the gas flow through the HP system, then the pressure is reduced to the LP level and the gas flows through the LP system. The system is operated this way to ensure safe and reliable delivery of natural gas to customers.

For example, the vast majority of Enbridge's customers are residential and commercial customers, both of whom are served off the LP system. Therefore, for the gas to get to a residential or a commercial burner tip, the gas has to travel through all three pressure categories. Consequently, residential (Rate 1) and commercial (Rate 6) customers are allocated the cost of all three pressure categories based on their respective contributions to peak demand on each pressure segment (TP, HP, or LP) of the distribution network.[506]

Rate 125 customers are served off the XHP system and are, therefore, only allocated the cost of the XHP (TP) system based on their contribution to the peak demand on the XHP system. This is a reasonable and appropriate approach.

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[505] 11Tr.14.

[506] The derivation of the relative cost responsibility among the three pressure categories is described at Ex.I.C30.EGDI.APPrO.7.

In this approach, if the customer class is being served off the XHP (TP) system, they are deemed to have caused a portion of the costs of that entire system. No further analysis or assessment is done to, for example, match the usage of the various pipeline sizes to the various customer classes or to match the operation and maintenance costs (such as the cost of integrity management or in-line inspection) to the various pipeline sizes. Stated differently, there is no examination of whether there are different levels of costs associated with different pipeline sizes.

Therefore, should the current Board-approved postage stamp cost allocation methodology be changed (i.e. to make it more detailed), it could not be done appropriately (reflecting postage stamp principles) based on an isolated parameter such as the pipe size. Other elements comprising the total cost of the XHP (TP) system and the allocation of these to the customer classes would need to be taken into account as well in order to maintain cost causality.[507] The approach proposed by APPrO does not accomplish this.

(iii) <u>APPrO's proposal to allocate smaller XHP pipelines away from Rate 125 is not appropriate</u>

APPrO's position on the "Over-Allocation Issue" is that only those XHP pipelines that "are being used to provide service to the Rate 125 customer class"[508] should be allocated to Rate 125. This means that no XHP pipelines of less than 12" in diameter would be allocated to Rate 125. Enbridge disagrees. The current approach, where a portion of the costs for all XHP pipelines is allocated to Rate 125 is appropriate.

As noted in the evidence, the Company is not proposing any changes to its Board-approved cost allocation methodology for 2014. Should the Company make a proposal to make a change to its Board-approved cost allocation methodology to Rate 125 or other rates, it would do so using a holistic approach (i.e. the proposed change is

[507] 11Tr.10.
[508] APPrO Written Submissions, p. 10.

evaluated comprehensively to make certain cost causality principles are maintained). As Mr. Kacicnik indicated in his opening remarks:

> Our rates are designed to recover the test year revenue requirement from customer classes, and the use of postage stamp ratemaking is supported by costing of its service at the average cost basis.
>
> This approach to setting rates does not differentiate between different investments and the mix of investment vintages. Our cost allocation methodology therefore appropriately and sufficiently determines the relative cost differences between different customer classes. In the company's view, it would be inappropriate to deviate from the Board-approved methodology. And if we were to do so, our suggestion would be to look at the issues on a broader basis, rather than only on the basis of treatment of specific investments.
>
> The company is of this view because some of the scenarios that we ran, even though those were limited, resulted in more costs being allocated to Rate 125 and some of them resulted in less. Therefore, we think that if we proceeded with this, a broader approach would be more appropriate.[509]

The fact that it is appropriate to look at a range of options if changes are made to Rate 125 cost allocation is confirmed by the fact that different options have different consequences. As Mr. Todd confirmed in testimony, at least one of the Rate 125 cost allocation options (allocation on the basis of peak hourly demand, rather than peak daily demand) that Elenchus identified would have resulted in higher costs to Rate 125 and lower costs to other rate classes.[510] Not surprisingly, however, the options that APPrO is advocating only reduce cost allocation to Rate 125.

If the Board determines, notwithstanding the foregoing submissions, that it is appropriate to make changes to the Rate 125 cost allocation, then the proper approach is different from what APPrO proposes.

First, Rate 125 should continue to bear cost responsibility for all XHP pipeline sizes that <u>can</u> be used to serve a Rate 125 customer (not solely those pipeline sizes that are currently used). This is consistent with Elenchus' recommendation that:

[509] 11Tr.7-8.
[510] 11Tr.95-96, discussing the options set out at Ex.I.C30.EGDI.APPrO.14.

> [T]he XHP function should be further broken down into those assets and expenses that can reasonably serve rate 125 customers and the rest of the XHP assets that cannot serve Rate 125 customers.[511]

Enbridge's evidence is clear that the minimum pipe size capable of serving an embedded Rate 125 customer is 6" in diameter.[512] This information was provided in an interrogatory response and explained in testimony by Mr. Kacicnik and Mr. Naczynski:

> Based on engineering analysis that was performed to confirm that a line of 6 inches in diameter could serve an embedded Rate 125 customer in addition to other loads. So this is based on engineering analysis, not just a hypothesis.[513]
>
> ....
>
> MR. VELLONE: Thank you. So when you suggest that Enbridge could use its 6-inch pipe system to service a Rate 125 customer, by my math that would represent a 397 percent increase from the current average peak flow that Enbridge has in its 6-inch pipe system from 6.3 times 10^3 to 25 times 10^3. Does that sound about right, subject to check?
>
> MR. NACZYNSKI: What I would suggest is that 25 plus 6.3 is 31,000 cubic metres on a peak hour, which is certainly well within the capabilities of a 6-inch extra high-pressure pipeline.
>
> MR. VELLONE: Okay.
>
> MR. KACICNIK: I would just add to Mr. Naczynski's response that the average flows that you see in the system today are the flows that are meeting the needs of our customers today. The way the pressure is distributed, the way the pressure is regulated, cut down and so forth, reflects the demands that we have to meet today.
>
> If we had many power generators in our system these flows would look vastly different. But we don't. We are mostly a residential and commercial utility. But at the same time, 6-inch-diameter pipe can accommodate flows at more than 30 10^3 per hour, and therefore it can serve an embedded power gen customer plus other loads on top of that.[514]

[511] Ex.L1-2-1, p.16; this phrasing was discussed by Mr. Todd at 11Tr.99 and 102.
[512] Exhibit I.C30.EGDI.APPrO.10
[513] 11Tr.28.
[514] 11Tr.23-25.

While it is true that Enbridge does not currently use pipelines less than 12" in diameter to serve Rate 125 customers, that is not the appropriate test to use for cost allocation. Instead, the proper approach under postage stamp ratemaking is to look at what assets could be used to serve a customer, and to allocate an appropriate proportion of those costs to the customer.[515] This is confirmed in Elenchus' conclusion that the key differentiation is between those assets that "can reasonably serve rate 125 customers and the rest of the XHP assets that cannot serve rate 125 customers." It is also confirmed in APPrO's own submission, where they state that their concern is that Rate 125 should not be allocated costs associated with XHP assets that "are neither being used to serve <u>nor are theoretically capable</u> of serving Rate 125 customers". (emphasis added) In cross-examination, Mr. Todd conceded that there is no "bright line" as to the dividing line between which pipeline sizes more than 4" and less than 12" should be allocated to Rate 125.[516]

Enbridge submits that, if it is determined that Rate 125 should only be responsible for costs of a portion of the XHP assets, the appropriate approach is to allocate a portion of the costs of all XHP pipelines of 6" in diameter or more to Rate 125. The impact is to reduce the costs shifted from Rate 125 by around $1.75 million per year, as compared to APPrO's proposal.[517]

Second, in the event that the Board decides to subdivide the XHP asset class into those pipeline sizes that serve Rate 125 customers and those that cannot, it is also appropriate to implement a corresponding change to the proportionate allocations of the costs of the two XHP pipeline categories to rate classes. While Mr. Kacicnik confirmed that classifying the system into TP, HP and LP pressure categories reflects cost

[515] APPrO's suggestion that because Enbridge could not currently serve a new Rate 125 customer using existing pipelines below 12" diameter is misleading. As Mr. Naczynski stated in testimony, the Company does not have sufficient excess capacity to be able to serve any new Rate 125 customer using pipelines of any size (11Tr.29). Reinforcements or new pipelines of an undetermined size would have to be installed to serve a new Rate 125 customer.

[516] 11Tr.101.

[517] Ex.I.C30.EGDI.APPRO.10, p. 4; see also 11Tr.73-74.

causality[518], cost causality would not be maintained if certain pipeline diameters and associated costs are removed from the cost of the XHP system, without making a corresponding adjustment to the Delivery Demand TP allocator to account for the demand that is met through those pipelines.[519]

This issue was discussed at length with Mr. Todd in cross-examination[520], and in an exchange with Ms. Chaplin[521]. There was full opportunity for APPrO's witnesses to respond.[522] While Mr. Todd was adamant that the wrong allocator is being applied for pipelines not used by Rate 125 customers, he did not explain why there should be no corresponding change/update to the appropriate allocator to use for those pipelines that can be used by Rate 125.[523]

In summary, if changes are to be made to the Rate 125 cost allocation methodology they should be done on a proper and holistic basis. If the Board believes that this so-called "Over-Allocation" issue merits further review, then it can be reviewed within a future Rate Adjustment proceeding.

(iv) No issue in relation to "excess capacity"

APPrO's second proposal relates to the alleged "Double Counting" of excess capacity. In its report, Elenchus had made two recommendations to address this item. In cross-examination, Mr. Todd conceded that the first of these recommendations (amend the Rate 125 economic feasibility test) would not assist the existing Rate 125 customers[524]

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518 11Tr.14-15.
519 The current allocation percentages for each rate class to each asset category are set out at Ex.G2-6-3.
520 11Tr.102-109.
521 11Tr.126-129.
522 While it is fair to say that Enbridge did not pursue this particular line of inquiry in interrogatories or examination in chief, that does not make the point less valid. It should be remembered that this item relates to a proposal from APPrO, not something that Enbridge is proposing. In any case, the line of inquiry was pursued in cross-examination of APPrO's witnesses, and was further explored in discussion between APPrO's witnesses and Ms Chaplin, meaning that APPrO had full opportunity to respond.
523 While Mr. Todd explained under an appropriate cost allocation approach, "we use different allocators based on pipe size" (11Tr.129), he did not expand upon why the Rate 125 allocator for pipe sizes above 6" (or 8") would not be impacted by moving away from the current approach where all XHP pipe sizes had been included in the determination of the existing 8.64% allocator.
524 11Tr.112.

and that Elenchus had no practical solution for implementing its second recommendation (shielding Rate 125 customers from portions of costs for new XHP pipelines that create excess capacity).[525] In the result, APPrO argues that Enbridge should be required to conduct further study of the issue and provide the Board and intervenors with a report in 2015, including an assessment of proposed solutions to remedy the alleged issues through the 2016 rate adjustment application.[526]

The premise for APPrO's proposal is that Rate 125 customers are unfairly treated because they have paid for "excess capacity" when they get connected to the system, and they are paying again for excess capacity through new reinforcement projects.[527] This premise is misleading.

At any given time, there is very little "excess capacity" in Enbridge's system. Therefore it is not the case that there was a considerable amount of excess capacity at the time that any customer is connected. The Company carries out system expansion and reinforcement in an optimized manner and compliant with EBO 188 guidelines. As a result, it is only for a short periods of time that installed capacity exceeds demand. This was explained in an interrogatory response to APPrO as follows:

> The amount of reserve capacity that exists or is being proposed in each of reference reinforcements is minor.
>
> Reinforcements are planned in a manner such that economies of scale in pipeline installation and meeting market growth are optimized. These projects conform to the EBO 188 guidelines for system expansion.
>
> For example, please refer to [evidence about phased Alliston reinforcements]. …. These reinforcements were phased such that only for short periods of time installed capacity exceeds demand.[528]

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[525] 11Tr.115.
[526] APPrO Written Submissions, p. 11.
[527] APPrO Written Submissions, p. 27; see also the testimony of Mr. Todd at 11Tr.109-110.
[528] Ex.I.C30.EGDI.APPrO.13, part c).

Moreover, Enbridge treats all new customers the same way. Enbridge is required to carry out feasibility assessment for any new customer in any rate class as prescribed by the Board in EBO 188.

Mr. Kacicnik testified to this in his opening remarks:

> Economic feasibility is not cost allocation and it's not rate design, it's an economic test or a screen prescribed by the Board so we can see if projects are feasible and they should proceed.
>
> Enbridge carries out economic assessment for any customer on any rate class as per the Board-approved guidelines in EBO-188. In the response to APPrO Interrogatory No. 12, issue C-30, Enbridge discusses how feasibility analysis is carried out. It basically looks or measures the cost of a project versus the revenues that will be received from that project, and the outcome of feasibility analysis is something that's called profitability index, or PI.[529]

The most recent new Rate 125 customers were connected to the system through new pipeline projects. The reason for this was not a different treatment of Rate 125 customers, but the relative size of these customers compared to Enbridge's existing customer base and as compared to any unutilized capacity in the system.[530] The same approach would have been used if these new customers were in a different rate class (for example Rate 115)[531].

When a new pipeline project or a system reinforcement is required to attach a Rate 125 customer (with or without other loads) Enbridge follows the Board-approved methodology for allocation and recovery of those costs. That is, the annual revenue requirement associated with the new project will be recovered in the test year across all

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[529] 11Tr.5-6.
[530] 11Tr.27.
[531] However, note that feasibility analysis for a Rate 115 customer would yield a higher project PI as delivery charges on Rate 125 are considerably lower than delivery charges on Rate 115. Rate 115 CD charge = 24.36 c/m3 (Ex.H2-6-1,p. 17), Rate 125 CD charge = 9.01 c/m3 (Ex.H2-6-1,p.19).

customer classes applying the Board approved cost allocation and rate design methodology.[532]

Rate 125 customers are not placed in a worse position than any other customer. To the contrary, it is Rate 125 customers who are subject to special treatment when it comes to feasibility analysis and recovery of capacity related costs. This is accomplished through the construct of billing contract demand, which was explained by Mr. Kacicnik:

> When speaking about the feasibility analysis, it's important to highlight the concept of billing contract demand, that's only applicable to Rate 125 customers on dedicated service. For those customers, if PI is greater than 1, then billing contract demand is established, which essentially lowers the revenue part of the equation to bring PI down to 1.
>
> And that billing contract demand would stay in place for those customers for the duration of their contract, which is typically 20 years. So in essence, they would be paying charges based on their billing contract demand rather than contract demand, which represents peak demand at the plant.[533]

As set out in response to an APPrO Interrogatory, and confirmed by Mr. Todd, Rate 125 customers would be allocated 13% of the Delivery Demand TP costs, rather than the current 8.6%, if these customers did not have the advantage of "billing contract demand".[534] This is a difference or around $5 million each year.[535]

For the reasons set out above, Enbridge submits that there is no meaningful issue to be addressed or solved in relation to "excess capacity" and Rate 125.

If the Board accepts APPrO's suggestion that this issue be moved to the 2016 rate adjustment proceeding for further review, Enbridge submits that the first item to be addressed is whether the so-called "Double Counting Issue" even exists in a meaningful way. That will require a full evidentiary record on matters such as the requirements of

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[532] This process is described in response to undertaking TCU3.18. This approach is also discussed in responses to APPrO Interrogatory Response #11, 13 and 14, found at Ex. I.C30.EGDI.APPrO.11, 13 and 14.
[533] 11Tr.6. See also the testimony of Mr. Todd at 11Tr.93-94.
[534] Ex.I.C30.EGDI.APPrO.14(c), at p.5; see also 11Tr.97.
[535] *Ibid*.

EBO 188, and the manner in which feasibility assessment (including treatment of reinforcement project costs[536]) is applied by Enbridge. It seems premature to develop "solutions", without agreement or determination on whether there is a problem.

d. Changes to Rates 100 and 110

Enbridge has proposed changes to Rates 100 and 110 in this proceeding. The changes to Rate 100 relate to the applicability provision and the structure of delivery charges.[537] These changes will provide an additional service option for certain large customers. The changes to Rate 110 will lower the minimum load factor applicability to provide greater choice to large customers, and facilitate continuity of service under Rate 110 for customers who undertake energy conservation and energy efficiency initiatives.[538]

BOMA[539], CME[540] and IGUA[541] have provided their support for the proposed changes. No party has indicated any opposition to the proposed changes.

e. Rate 332

For approval within this case, Enbridge has proposed Rate 332 for transportation service customers (Shippers) on Segment A of the GTA project. The Rate 332 monthly charge is designed to recover the Shippers' portion of the Segment A costs within the GTA project. In the EB-2012-0451 proceeding, the Company proposed that the derivation of the annual revenue requirement and determination of Rate 332 monthly charge be considered on a stand-alone basis. The revenue requirement for Segment A will be based on a cost-of-service methodology and will include costs for administration, operation, maintenance, depreciation, cost of debt, return on equity, and municipal and

[536] The EBO 188 guidelines appropriately differentiate between the economic feasibility for customers where a pipeline project is specific to the customer versus the economic feasibility for customers who attach to pipelines that were built to serve future growth.
[537] Ex.H1-2-2, p.1.
[538] Ex.H1-2-3, pp.1-2.
[539] Submissions of BOMA, p. 57.
[540] Argument of CME, p. 24.
[541] IGUA Supplemental Written Submissions.

income taxes. As per the Board's decision in EB-2012-0451, 60% of the annual revenue requirement for Segment A will be recovered from Shippers through Rate 332 contract demand (CD) charges. The Rate 332 monthly CD charge will recover Shippers' share of the annual revenue requirement through a contract demand charge for contracted capacity.[542]

Two parties made submissions on Rate 332 (Issue E44).

BOMA recommends that the Board not issue a decision on the rate in this proceeding, stating "the evidence does not indicate how the shipper's share is to be determined, including whether a range rate concept would be used as originally proposed." In EB-2012-0451/EB-2012-0433/EB-2012-2013-0074 (the GTA Proceeding)[543], Enbridge provided a copy of an Open Season Information Package which describes, among other things, a range of potential demand charges Shippers could expect as Rate 332 customers. This should not be confused with a proposal for a "range rate concept". The range of potential demand charges was provided in the Open Season Information Package to aid Shippers considering taking service under Rate 332, with a precise demand charge to be calculated when all variables are determined, including the level of contracted capacity.

As described in evidence in the GTA Proceeding[544], the calculation of Rate 332 is done "in proportion to the amount of capacity reserved for Rate 332 customers", whereby "Enbridge proposes to charge 60% of this fully allocated revenue requirement for the Albion Pipeline through the new Rate 332 transportation services charge."

Enbridge submits, therefore, that there is appropriate (and sufficient) evidence available to allow the Board to approve Rate 332.

APPrO does not object to Rate 332, but identifies that GTA Project Segment A could lead to "opportunities to generate Transactional Services (TS) revenue during off-peak

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[542] Ex.H3-1-1, pp.5-6.
[543] EB-2012-0451, response to BOMA Interrogatory #2 (Exhibit I.A1.EGD (Update).BOMA.2).
[544] EB-2012-0451, Ex. E-1-2.

periods using Enbridge's unused capacity."[545] APPrO suggests that this justifies Enbridge proactively developing an interruptible service for that path. While the Company acknowledges the project could provide these opportunities, TS transactions are carried out in accordance with the Board's decisions on TS for Enbridge and, accordingly, do not require any changes to the proposed Rate 332 service or to the Rate Handbook. Should an opportunity arise at a future time for further services on this path, the Company will put forth a proposal for a new rate or service in accordance with the process described below in section 13(g).

f. Changes to the Rate Handbook

Enbridge has proposed modest changes to Terms and Conditions within its Rate Handbook, with the proposed addition of Section P. That provision will obligate the Company and large customers to meet once annually to review customers' expected consumption and to confirm that emergency contact information that the Company has on file is current.[546]

These are the largest customers on the gas distribution network and Enbridge's knowledge of details regarding their consumption characteristics is important to ensure the safe and reliable operation of the network. Specific knowledge of these customers' anticipated consumption allows these customers to be uniquely identified in the network planning model to ensure their demand is accurately represented and that the distribution system can reliably meet their peak demand requirements. This also allows Enbridge to readily contact these customers in an unplanned network emergency. It naturally follows that this information is needed whether the customer purchases their own gas supply or relies on gas supply from Enbridge, as all customers are served from the same distribution network.[547]

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[545] Written Submissions of APPrO, p. 52.
[546] Ex.H1-2-1, p. 1.
[547] Ex.H1-2-1, pp. 1-2.

The only party to respond to this item (Issue E43) is APPrO, who state that the requirement ought not to apply to contract customers. APPrO indicates that it was up to Enbridge to require such information when its contracts were formed, and it should not now be mandated.[548] Enbridge disagrees.

First, it should be noted that contract customers with contracts which renew annually are already in compliance with the provision in the proposed Section P.[549]

Further, the intent of the proposed Section P is fulfilled through the existing "Annual Consumption Forecast" provision/clause for customers with longer term contracts, such as Rate 125 customers:

> The customer shall provide to the Company, for each Terminal Location, not less than sixty (60) days prior to the commencement of each Contract Year for such Terminal Location, an annual forecast of daily gas consumption expressed in cubic metres identifying expected daily flows, expected down times and anticipated peak consumption periods.[550]

Therefore, while the proposed Section P would be applied universally, it would effectively only impact General Service customers. These customers will be provided with assistance in the new process.[551]

APPrO also sets out a number of further recommendations.[552] The following are the Company's responses.

Enbridge agrees with the recommendation that the consumption and emergency contacts information will only be provided upon request from the Company. That is how the process has been intended to function.

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[548] Written Submissions of APPrO, pp.50-52.
[549] This point has been addressed at Ex. H1-2-1, where it is stated that "the provision has no undue impact on contract rate customers", and that "the obligated information for these customers is already updated / refreshed annually through the contract renewal process."
[550] This is set out in response to APPrO Interrogatory 16 (Ex.I.E43.EGDI.APPrO.16).
[551] Exhibit I.E43.EGDI.OAPPA.8.
[552] Written Submissions of APPrO, p. 52.

Enbridge acknowledges that it will appropriately safeguard customer specific confidential and sensitive information.[553]

Finally, Enbridge does not agree that the requirement to provide annual consumption information be limited to customers for which Enbridge procures gas supply. It is important to recognize that up to date emergency information and consumption patterns of large customers – whether System Gas or Transportation Service – can play important roles in the planning, safety, and reliability of the gas distribution network. The key purpose of this provision is to ensure the most current information between the Company and large volume customers is maintained to ensure safe and reliable operation of the gas distribution network.

g. Future Changes in Rate Design and New Energy Supply Services

Within the Rate Adjustment Process evidence, Enbridge indicated that it requires flexibility during the Customized IR plan term to develop new rates and services, make specific changes to existing rates, and change or introduce miscellaneous or non-energy services. Proposals for any such new or amended rates or services will be presented to the Board for approval, within a rate adjustment or separate proceeding.[554]

BOMA[555] and Energy Probe[556] indicated their support for Enbridge's proposal (which is included as Issue A13 within this proceeding). No party indicated any opposition to this proposal.

h. Gas Supply Reporting

As noted in the Final Argument of FRPO[557], Enbridge agreed within the October 2013 Settlement Agreement related to Enbridge's 2014 Gas Supply Plan to provide monthly

[553] This issue is addressed in the response to APPrO Interrogatory #16 (d) (Ex.I.E43.EGDI.APPrO.16).
[554] Ex.A2-3-1, pp. 12-13.
[555] Submissions of BOMA, p.44.
[556] Final Argument of Energy Probe, p.27.
[557] Final Argument of FRPO, pp. 17-18.

reporting related to the use of new FT service acquired from TCPL and associated UDC.[558] Subsequently, in response to discussions with FRPO, Enbridge agreed to provide further items within the monthly reporting.[559] Then, during the examination of the gas supply panel at the hearing, Enbridge agreed to provide one additional item (monthly storage targets).[560]

In its submission, FRPO has requested further monthly reporting be added to the items noted above. Specifically, FRPO requests that Enbridge provide monthly reporting on the amount of FT capacity that is assigned to third parties through a UDC-related "outright release" (as differentiated from a capacity release exchange transaction), and the revenue generated from such transactions.[561]

Enbridge is prepared to provide this additional reporting, and has commenced doing so within its latest monthly report, which was filed with the Board on April 30th.

FRPO also requests that Enbridge annually prepare a Gas Supply Plan memorandum consistent with what is being prepared and provided by Union Gas.[562] The items that FRPO identifies as being included within the Gas Supply Plan memorandum are:

> (i) summary of the current natural gas market situation;
>
> (ii) the results of the design day demand forecast with a discussion of the underpinning assumptions;
>
> (iii) an overview of the current gas supply portfolio;
>
> (iv) identification of near term portfolio decisions and a description of how the [Enbridge] strategy for the specific portfolio decision conforms to the gas supply planning principles; and
>
> (v) a summary of major upstream pipeline regulatory filings and/or recent regulatory orders (e.g., RH-003-2011); physical infrastructure projects that will likely impact [Enbridge]; and implications associated with gas supply

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[558] Ex.N1-2-1, pp. 6-7.
[559] See Exhibit K8, and discussion at 8Tr.25-28.
[560] 8Tr.29
[561] Final Argument of FRPO, pp. 21-22.
[562] Final Argument of FRPO, pp. 22-23.

> basins as a high level discussion of these regulatory and market drivers in the [Enbridge] gas supply plan will provide market context for [Enbridge]'s stakeholders.

Enbridge is prepared to annually prepare a Gas Supply Plan memorandum addressing the above items. The contents of the Gas Supply Plan memorandum would be consistent with what is set out within the April 2014 Union Gas Supply Plan memorandum that was presented at the Union Gas Stakeholder Meeting. Enbridge proposes that it would include the Gas Supply Plan memorandum each year as part of the materials to be provided to stakeholders in connection with the annual stakeholder meeting that Enbridge has agreed to hold (as discussed earlier).

i. Allocation of Costs between Utility and Non-Utility Operations

FRPO was the only party to provide submissions on Issues B17(c), B18(e) and B19(c), which relate to the allocation of costs between Utility and Non-Utility Operations. FRPO submits that Enbridge should allocate part of its currently allowed provision for Lost and Unaccounted For (LUF) gas to unregulated storage. FRPO indicates that the allocation should be made in proportion to the percentage of overall storage volume that is represented by unregulated storage operations.[563]

Enbridge does not agree that this approach is appropriate.

The volume associated with Enbridge's current Board-approved provision for LUF was set prior to the development and operation of its additional unregulated gas storage capacity, and has not changed. No party has disputed the LUF provision within this proceeding. The LUF volume underlying the Board-approved LUF provision was based upon the storage reservoir pressures and injection/withdrawal activity that were associated with the approximate 98 Bcf of utility storage capacity existing before the

[563] Final Argument of FRPO, p. 24.

NGEIR decision and the development of unregulated storage.[564] The LUF provision allows for recovery of that gas volume from utility storage customers.

In the result, there have been no incremental costs to utility customers for LUF as a result of unregulated storage activities.[565] Utility storage customers are not paying for any additional LUF volume than was the case prior to the development of unregulated storage capacities. As the LUF volumetric provision is based solely on the utility storage capacity, the associated costs should be recovered from utility ratepayers.[566]

At this time, Enbridge has not determined if there has been a change in the LUF volumes that it is experiencing since the inception of its Unregulated Storage service offerings. As noted in response to discovery questions from FRPO, Enbridge has undertaken a new engineering study to assess LUF volumes associated with its overall storage business.[567] The results of the study are not yet complete.[568] Enbridge is aware that, to the extent that LUF volumes are found to have changed as a direct result of the operating changes that unregulated gas storage brings, the unregulated storage business, and Enbridge's shareholder, are at risk for the additional LUF cost that is associated with that change. Should it be determined that there is a change in the LUF volumes experienced, Enbridge will commit to recovering those gas volumes in a manner that recognizes and respects cost causation principles. Until the time that there is sufficient empirical data for Enbridge to determine that its LUF volumes have changed, there is no basis to alter the current LUF allocation.

j. Implementation Date for 2014 Rates

Final rates for 2014 will be set within this proceeding. No party disputes that the full-year impact of any changes in rates from the current interim rates should be recovered.

[564] Ex.I.B17.EGDI.FRPO.13, which references and attaches Undertaking JT2.1 from EB-2012-0459.
[565] Ex. TCU3.6. FRPO submits that this response is "cryptic" (Final Submissions of FRPO, p. 24). Enbridge disagrees. In any case, no follow-up questions were asked about this response, when FRPO cross-examined Enbridge witnesses at the oral hearing.
[566] Ex.I.B17.EGDI.FRPO. 14.
[567] Ex.I.B17.EGDI.FRPO. 13 and 15 and Ex. TCU3.7.
[568] Ex.I.B17.EGDI.FRPO. 13.

Within Argument in Chief, the Company proposed that final 2014 rates should be implemented in conjunction with the next QRAM Application in which implementation can feasibly be achieved after the Board's Decision and approval of the associated Rate Order.[569] Along with the final rates, Enbridge proposes to implement two Riders. The first (Rider E) will credit ratepayers with the difference in revenue between interim and final 2014 rates for the period from January 1, 2014 to the date when final rates are implemented. The second (Rider D) will credit ratepayers with the 2014 portion of the SRC reserve that is to be refunded.

Energy Probe suggests that the final rates be implemented in the first month after they are approved, along with a one-time credit for the difference between interim and final rates, rather than waiting for a QRAM Application.[570]

Assuming that the Board's Decision can be implemented into rates within the October 1, 2014 QRAM, Enbridge believes that its proposed approach is preferable. This approach avoids the cost and potential customer confusion which could result from having a rate change implemented into billing outside the established quarterly rate change mechanism.

However, if the next QRAM Application following the Board's Decision and approval of the associated Rate Order is the January 1, 2015 QRAM, then Enbridge agrees that a different approach may be appropriate because of a number of overlapping deliverables at year end (such as a January 2015 QRAM application and preparation of year-end financial statements). Implementation of the final 2014 Rate Order at the same time could be quite challenging. Therefore, Enbridge proposes that if it is not possible to implement final 2014 rates in conjunction with the October 1, 2014 QRAM, then the Company could, if timing allows, take steps to implement the final 2014 rates as of either November 1st or December 1st (depending on the timing of the Board-approved Rate Order).

[569] Argument in Chief, pp 78-79.
[570] Final Argument of Energy Probe, p. 42.

14. Conclusion

In conclusion, Enbridge submits that there is a solid and cogent evidentiary base supporting a series of propositions that individually and collectively give weight to Enbridge's request for approval of the Customized IR Plan. This series of propositions, each of which is addressed within Enbridge's Argument in Chief and Reply Argument, is set out below.

Before listing the propositions, it is important to emphasize that each of them is firmly grounded in the evidence that the Company has filed in this case. Enbridge's evidence, which did not receive very much attention within intervenor arguments, sets out a strong foundation for the Customized IR plan. Enbridge's core pre-filed evidence explains and justifies, among other things:

(i) the need for the Customized IR plan, and the factors and sources of guidance that contributed to the development of the plan (Exhibits A2-1, A2-9 and A2-10);

(ii) the elements of the Customized IR plan, including a rate adjustment mechanism, appropriate features to encourage investments in sustainable efficiency measures, improved Z Factor wording, an ESM to share rewards from superior performance, and appropriate monitoring and reporting of the Company's costs and performances (the balance of the A2 Exhibits);

(iii) the rigorous cost forecasts of capital and O&M spending requirements, including embedded productivity savings, that are reflected within Allowed Revenue (the B and D series of exhibits); and

(iv) the SRC proposal, which will result in adoption of a conceptually preferable methodology, a substantial refund to customers and reduced rates (Exhibit D1-5-1 and D2-1)

Enbridge submits that the following series of propositions, which are established based upon the comprehensive and compelling evidentiary record in this case, individually and collectively substantiate Enbridge's request for approval of the Customized IR Plan.

IR Model

Customized IR is the appropriate methodology to fit Enbridge's circumstances.

Argument in Chief, pp. 8-21 and Reply Argument, pp. 2-9 and 30-34

An I Minus X model is not appropriate for Enbridge's circumstances over the period from 2014 to 2018.

Argument in Chief, pp. 13-14 and 18-19 and Reply Argument, pp. 30-34

There is no basis in this case for approval of an alternative IR model.

Argument in Chief, pp. 20-21 and Reply Argument, pp. 15-21

An IR Model should be aimed at sustainable efficiencies, not arbitrary cost cutting.

Argument in Chief, pp. 10-12 and Reply Argument, pp. 9-15

The Customized IR Plan

The proposed Customized IR Plan meets the Board's objectives.

Argument in Chief, pp. 4 and 9-10 and Reply Argument, p. 2

More particularly, the proposed Customized IR Plan meets the requirements of the RRFE for Custom IR.

Argument in Chief, pp. 14-16 and Reply Argument, pp. 21-30 and 37-51

The Customized IR Plan is consistent with the Building Blocks approach.

Argument in Chief, p. 5 and Reply Argument, pp. 34-37

The Customized IR Plan takes a multi-level approach to productivity and efficiency, including productivity embedded in forecasts, a proposal for Productivity Initiatives Reports and the proposed Sustainable Efficiency Incentive Mechanism.

Argument in Chief, pp. 10-12, 37-38, 50-52 and 68-70 and Reply Argument, pp. 9-15, 46-47, 70-71, 81-82 and 91-92

The Customized IR Plan delivers on the Value for Money proposition enunciated in the RRFE Report.

Reply Argument, pp. 5-9

<u>**Elements of the Customized IR Plan**</u>

Enbridge proposes Z Factor wording and has indicated its acceptance of changes to that wording proposed by Board Staff (except for any change to the materiality threshold).

Argument in Chief, pp. 65-67 and Reply Argument, pp. 60-63 and Board Staff Submission, pp. 38-39

Enbridge proposes an Earnings Sharing Mechanism and has indicated its willingness to accept changes to the proposed ESM.

Argument in Chief, pp. 67-68 and Reply Argument, pp. 63-66

Enbridge proposes the SEIM in order to give effect to the Board's direction that IR should include incentives for sustainable efficiencies and a number of parties have recognized the merit of the underlying purpose of the SEIM.

Argument in Chief, pp. 68-70 and Reply Argument, pp. 11-15 and Final Argument of Energy Probe, p. 22 and Written Submissions of APPrO, p. 43 and Final Argument of SEC, p. 61

The SEIM is the only mechanism proposed in this case to establish incentives focused specifically on sustainable efficiencies, but, should the Board not accept any of Enbridge's suggestions regarding the SEIM, Enbridge accepts an alternative approach suggested by SEC.

Argument in Chief, p. 70 and Reply Argument, pp. 14-15 and Final Argument of SEC, p. 62

The Customized IR Plan includes an annual rate adjustment process, as was the case with Enbridge's previous IR plan; Enbridge proposes that volumes (but not customer additions), gas cost related items and other pass-through items be subject to the annual adjustment process.

Argument in Chief, pp.56 and 64-65 and Reply Argument, pp. 52-53

Enbridge proposes continuation of most existing Deferral and Variance Accounts, as well as a small number of new accounts, to ensure that both ratepayers and Enbridge do not receive inappropriate benefits from, or suffer inappropriate burdens of, costs that should be treated as pass-through items.

Argument in Chief, pp. 73-76 and Reply Argument, pp. 119-127

Enbridge proposes a variance account to record costs related to the GTA Project in order to ensure that amounts ultimately recoverable in rates reflect the actual costs and timing of the project.

Argument in Chief, p. 75 and Reply Argument, pp. 124-125

Monitoring and Reporting of Costs and Performance

Enbridge will report on its capital spending to enable the Board to monitor such spending in a manner consistent with the requirements for Custom IR under the RRFE Report.

Reply Argument, pp. 48-49 and 69-70

Enbridge proposes a Performance Measurement Framework, which includes reporting on Productivity Initiatives and Performance Metrics Benchmarking.

Argument in Chief, pp. 9-10 and Reply Argument, pp. 7-9 and 66-70

Cost and Revenue Forecasts

Enbridge has provided robust evidence of cost and revenue forecasts, and there has been very little specific challenge to any of those forecasts.

Argument in Chief, pp. 21-57 and Reply Argument, pp. 40-43 and 75-104

Enbridge's evidence shows that it is facing large multi-year capital investment commitments for major reinforcement projects in Toronto and Ottawa, and that it has substantial safety and integrity spending requirements in the coming years that are well above the level reflected in current rates.

Argument in Chief, pp. 21-37 and Reply Argument, pp. 78-83

Enbridge proposes a new Work and Asset Management System to replace technology that will no longer be vendor-supported because, without the new WAMS, Enbridge's operations would be put at significant and unacceptable risk.

Argument in Chief, pp. 33-37 and Reply Argument, pp. 83-88

Enbridge's Core Capital budgets are set at the lowest prudent level that will enable the Company to operate its growing distribution system in a safe manner, consistent with regulatory requirements (including evolving TSSA requirements).

Argument in Chief, pp. 21-31 and Reply Argument, pp. 78-83

By assuming productivity savings and taking onto itself the risk of variable costs, Enbridge has put forward a Core Capital budget that declines relative to inflation while accommodating important and growing capital expenditure requirements.

Argument in Chief, pp. 21-28 and 37-38 and Reply Argument, pp. 78-83

Enbridge has demonstrably proven the reasonableness of its Other O&M budgets in several compelling ways.

Argument in Chief, pp. 43-53 and 71-73 and Reply Argument, pp. 88-93

Enbridge has provided benchmarking evidence in support of its forecasts and no other party has put forward a benchmarking study.

Argument in Chief, pp. 50 and 71-73 and Reply Argument, pp. 21-30, 47-48, 84 and 91

Site Restoration Costs Proposal

Based on Gannett Fleming's recommendations following a two-phase review, Enbridge proposes to return $259.8 million of SRC to customers by way of a rate rider.

Argument in Chief, pp. 16-18 and 58-64 and Reply Argument, pp. 111

The other impacts of adopting Gannett Fleming's recommendations result in reductions to Allowed Revenues cumulatively totaling $241.4 million over the term of the Customized IR Plan.

Argument in Chief, pp. 58-59 and Reply Argument, pp. 117-118

A wide range of other ideas has been propounded on the SRC issue, but Enbridge's proposal is the only approach that is solidly grounded in evidence, it represents a reasonable middle-ground among divergent suggestions made by others and it has a rate and bill mitigation effect.

Argument in Chief, pp. 16-18 and 58-64 and Reply Argument, pp. 111-118

Cost of Capital

Enbridge has provided a forecast of the cost of capital during each year of the proposed IR term because this category of costs should be treated consistently with other costs in the Customized IR plan.

Argument in Chief, pp. 38-41 and Reply Argument, pp. 53-59

Should the Board consider it more appropriate that the cost of capital be set each year during the annual adjustment proceeding, this approach is also acceptable to Enbridge.

Reply Argument, pp. 58-59

Other Matters

Enbridge proposes a heating degree day methodology for the Central operating region that is a hybrid of the two most reliable methodologies and Energy Probe supports the hybrid methodology.

Argument in Chief, p. 57 and Reply Argument, pp. 129-130

Enbridge proposes that the parameters for the Transactional Services Deferral Account be changed to remove the guaranteed amount of net revenues, because there is substantial uncertainty at this time about future TS opportunities and likely future TS revenues.

Reply Argument, pp. 121-124

Enbridge's proposed changes to Rates 100 and 110 are supported by intervenors, but neither Enbridge nor Board Staff nor any other party supports APPrO's proposed changes to Rate 125.

Argument in Chief, pp. 76-77 and Reply Argument, pp. 130-144 and Board Staff Submission, pp. 68-69 and Submissions of BOMA, p. 57 and Argument of CME, p. 26 and Final Argument of Energy Probe, p. 41 and Supplemental Written Submissions to IGUA's Final Argument and Written Submissions of APPrO, pp. 1-31

Outcomes

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

Argument in Chief, pp. 3 and 78-80

The overall outcome of the Customized IR plan is that Enbridge is able to meet its coming challenges and deliver significant benefits and value to customers at reasonable rates.

Argument in Chief, pp. 79-81 and Reply Argument, p. 159

As explained, the Customized IR plan enables Enbridge to meet important capital spending needs -- for purposes such as the GTA Project, WAMS and safety and integrity requirements – and the opportunity to achieve a fair return on substantial capital investments, with reasonable rate impacts. Further, the implementation of Enbridge's SRC proposal operates so as to reduce both rate and bill impacts. The overall outcome is that Enbridge is able to deliver significant benefits and value to customers, including the benefits of the GTA Project, at distribution rates that are reasonable and that are further moderated by the rate and bill mitigation effect of the SRC proposal. Enbridge submits that the Customized IR plan produces a fair and balanced outcome for ratepayers and for the Company.

All of which is respectfully submitted, May 7, 2014.

"Original Signed"

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