ONTARIO ENERGY BOARD

STAFF SUBMISSION
ENBRIDGE GAS INC.
2019 RATES APPLICATION
EB-2018-0305

July 4, 2019

Background

On August 30, 2018, the Ontario Energy Board (OEB) approved the amalgamation of Enbridge Gas Distribution Inc. and Union Gas Limited.[1] In its decision, the OEB also approved a rate-setting framework and associated parameters for the deferred rebasing period of 2019 to 2023. The companies amalgamated effective January 1, 2019, and the new company is called Enbridge Gas Inc. (Enbridge Gas). Enbridge Gas is the largest natural gas distribution utility in Canada serving over 3.5 million customers.

Enbridge Gas filed a complete rate application with the OEB on December 14, 2018 under section 36(1) of the *Ontario Energy Board Act, 1998* seeking approval for charges to its natural gas rates effective January 1, 2019. On December 3, 2018, the OEB declared the current rates of Enbridge Gas to be interim effective January 1, 2019 based on the initial application[2] dated November 23, 2018, until the OEB issues a final rate order in this matter.

In Decision and Procedural Order No. 2 dated April 1, 2019, the OEB approved an Issues List for the proceeding. In that decision, the OEB determined that gas supply planning is out of scope in this proceeding and the OEB would not review the gas cost consequences of the 2019 Gas Supply Plan for the Enbridge Gas Distribution rate zone. Union Gas on the other hand recovers the gas cost consequences through the Quarterly Rate Adjustment Mechanism.

A settlement conference was held on May 13 and 14, 2019. Some issues were settled but the major issues remained unresolved. In Decision and Procedural Order No. 4 dated June 10, 2019, the OEB accepted the settlement proposal and scheduled a written process for the hearing of the unsettled issues.

OEB staff has provided a summary of its position on the unsettled issues below. A detailed discussion, organized according to the Issues List, follows.

Summary of OEB Staff Positions on Key Issues

- Enbridge Gas should use the 2019 Price Cap Index (PCI) and not the average PCI to determine the Incremental Capital Module (ICM) materiality threshold for the Union Gas rate zone.

[1] EB-2017-0306 / 0307 (the MAADs Decision).
[2] The initial application requested interim rates

- The OEB should deny Enbridge Gas' request to include Operating and Maintenance costs and property taxes in the related ICM deferral accounts to determine the ICM revenue requirement.
- The one-time adjustment for capital pass-through projects should be denied. The capital pass-through deferral accounts for the Union Gas rate zones should continue as approved in the Merger, Amalgamation, Acquisition and Divestiture (MAADs) Decision.
- OEB staff submits that $13.4 million in Information Technology (IT) spending for 2019 can be deferred to a future price cap rate application pending the review of the integration of IT business services that is expected to be completed by the end of 2019.
- The Don River Replacement project and the Stratford Reinforcement Project do not qualify for ICM funding.
- The Sudbury Replacement project should be approved under Union Gas' capital legacy Y factor mechanism and not as an ICM eligible project.
- The Kingsville Reinforcement project qualifies for ICM funding.
- Enbridge Gas should be required to revert back to the previous customer connection policy for the Enbridge Gas Distribution rate zone.

Issues List

1. Has Enbridge Gas responded appropriately to all relevant OEB directions from previous proceedings?

Although this issue was not settled, the question as to whether Enbridge Gas has responded appropriately to all directions from previous proceedings is a matter that is discussed in the context of specific issues that remain unresolved.

2. Is the Price Cap Index calculated appropriately?

For purposes of setting 2019 rates, the PCI calculation of 1.07% is settled. The issue of whether the PCI used to determine Union Gas rate zones' ICM materiality threshold is appropriate, is discussed below.

In its application, Enbridge Gas used a PCI of 0.72% for calculating the Union Gas ICM materiality threshold, which is the average of the actual annual PCI used to increase rates during its price cap plan which began in 2014. For the Enbridge Gas Distribution rate zone, the 2019 PCI of 1.07% has been used to calculate the ICM materiality threshold.

Enbridge Gas submitted that the average PCI for the Union Gas rate zone more accurately reflects the impact PCI has had on rates and revenue since the base year (2013 rates for Union Gas) than the use of the current year PCI. Enbridge Gas noted that during Union Gas' 2014-2018 IRM, rates were adjusted by 60% of inflation, and not subject to the OEB's prescribed I-X formula. Enbridge Gas further argued that the use of the average PCI also reduces the year-to-year fluctuations in the threshold value that would occur by using the current year PCI.

The OEB's policy in this case is clear. In the *Report of the Board on New Policy Options for the Funding of Capital Investments*, the OEB states, "For ICM requests and ACM rate rider approvals in a Price Cap IR application, distributors should use the most recently approved IPI and stretch factors".[3] There is no evidence in this proceeding to suggest that using the recent PCI (1.07% for 2019) would lead to large year-to-year fluctuations in the threshold value. In addition, OEB staff notes that the companies (Enbridge Gas Distribution and Union Gas) are one entity now and OEB staff sees no reason why the same company should use two different PCI values to determine the ICM materiality threshold value.

In the MAADs Decision, the OEB approved an inflation factor (a determinant of the base rate PCI) that was based on calendar year-over-year comparison as compared to the mid-year calculation used by Union Gas in its previous IR mechanism.[4] In other words, the methodology to determine the inflation factor used to calculate PCI for 2019 rates is different than what Union Gas used previously. Further, the approach to update the Union Gas rate zone with the rate base and depreciation to align with that of the Enbridge Gas Distribution rate zone as the starting rate base-to-depreciation ratio for the purposes of calculating the materiality threshold, means that it is the current inflation index methodology, and not that used previously by Union Gas, which is pertinent during the current Price Cap plan.

OEB staff sees no reason to depart from OEB policy on capital funding options or the determinations of the OEB with respect to the inflation factor in the MAADs Decision for purposes of calculating the PCI to determine the ICM materiality threshold for the Union Gas rate zone. OEB staff submits that Enbridge Gas should be required to use the current year PCI for the Union Gas rate zone in order to determine the ICM materiality threshold.

Using the current year PCI, the materiality threshold value for the Union Gas rate zone increases from $375.2 million to $398.5 million.[5] The resulting Maximum Eligible

[3] Report of the Board – New Policy Options for the Funding of Capital Investments: The Advanced Capital Module, EB-2014-0219, September 18, 2014, p.21.
[4] EB-2017-0306 / 0307, Decision and Order, August 30, 2018, p.25
[5] LPMA IRR#11

Incremental Capital drops from $143.3 million to $120 million.[6] Enbridge Gas could confirm this number in reply.

3. Does the accounting order wording in the following new accounts appropriately reflect the OEB's MAADs Decision?

   a) Earnings Sharing Mechanism Deferral Account (Enbridge Gas)
   b) Tax Variance Deferral Account (Enbridge Gas)
   c) Accounting Policy Changes Deferral Account (Enbridge Gas)

This issue is settled.

Nevertheless, OEB staff wishes to add some comments on the Tax Variance Deferral Account (TVDA). In doing so, it is not the intention of OEB staff to second-guess or interfere with the settlement, that OEB staff supported and which was accepted by the OEB.

The issue as framed in the OEB's Issues List Decision was narrow: Do the accounting orders reflect the intent of the MAADs Decision? OEB staff had no concerns in that regard. However, OEB staff wishes to bring to the OEB's attention a recent interim rate order and a decision of the OEB that were made after the settlement was agreed upon (and after staff's submission was filed) that relate to a recent tax change that is expected to have a material impact on Enbridge Gas's revenue requirement.

By way of background, in the November 21, 2018 Federal Economic Statement, the Finance Minister of Canada tabled plans for a tax incentive program, the *Accelerated Investment Incentive* (AII), which provides for accelerated tax deductions through the Capital Cost Allowance (CCA) on eligible capital assets. Federal Bill C-97, the *Budget Implementation Act, 2019, No. 1,* which included the AII program, received Royal Assent on June 21, 2019. The AII allows for an increase in CCA deductions in the year of acquisition on eligible capital assets acquired after November 20, 2018. The AII does not change the total CCA deductions allowed to be claimed for an asset, but accelerates the timing of the claim so that the CCA deduction is larger in the first year of acquiring an asset than prior to the AII program.

As part of its partial settlement proposal filed on May 29, 2019, Enbridge Gas provided a calculation of the impact of the AII on revenue requirement.[7] The 2019 revenue

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[6] Exhibit B1, Tab 2, Schedule 1, p.16, In-service capital of $518.5-$398.5=$120.0 million.
[7] Enbridge Gas Inc. Settlement Proposal dated May 29, 2019, Attachment 3.

requirement impact of implementing accelerated CCA on 2019 capital additions would range from a decrease of $26 million to $39 million. The revenue requirement impact of implementing accelerated CCA on the requested ICM projects is estimated to be a decrease of $4 million, which would be captured in the ICM deferral accounts that were settled in this proceeding. OEB staff expects that Enbridge Gas will file a similar impact statement for the 2020 calendar year with their 2020 incentive rate-setting application.

In the MAADs Decision, the OEB approved the continuation of Union Gas' Tax TVDA and expanded the applicability of the account to both the Enbridge Gas Distribution and Union Gas legacy areas. The purpose of the account is to record 50% of the difference between actual taxes and approved taxes due to tax changes resulting from, among other things, changes to federal or provincial tax legislation.

The TVDA currently records 50% of the difference between actual and approved taxes. The TVDA is similar to electricity distributors' generic Account 1592 PILS and Tax Variances, which records the impact of any differences that result from a legislative or regulatory change to the tax rates or rules assumed in the OEB Tax Model. A 50/50 sharing of tax impacts was determined to be appropriate by the OEB in the *Supplemental Report of the* Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors (3rd Generation Report).

In Hydro One Network Inc.'s interim rate order for electricity distribution rates[8] and Energy+ Inc.'s cost of service decision[9], the OEB noted that the utilities had Account 1592 or an equivalent account. The OEB directed both utilities to establish a new sub-account for the purposes of recording the impact of changes in CCA rules, effective November 1, 2018 (the date where accelerated CCA is first implemented). Regarding the 50/50 sharing of the tax impact, the OEB directed Hydro One Networks Inc. and Energy+ Inc. to:

> …record the full revenue requirement impact of any differences between the CCA rules and assumptions used in setting base rates in a given year, and the rules in effect for that year. The determination of the disposition methodology and allocation of any accumulated balances in this new 1592 sub-account will be made by the OEB when these balances are brought forth for disposition at a future date. The OEB's future determinations regarding the disposition of this new sub-account will not be bound by the 50/50 sharing criterion identified in the 3rd Generation Report.

While the settlement agreement in this proceeding does not explicitly speak to the AII program, the quantification of the impact of the program in Attachment 3 of the

[8] EB-2017-0049 Interim Rate Order, June 6, 2019
[9] EB-2018-0028 Decision and Order, June 13, 2019

settlement agreement combined with the settlement of the TVDA accounting order implies that parties have agreed on a 50/50 sharing of the tax impact for the 2019 calendar year.[10]

The sharing of tax impacts from the AII program was not in scope for this proceeding as it was not included in the approved Issues List. However, in light of the two recent electricity distributor cases referenced above, OEB staff submits that this issue should be considered in Enbridge Gas' 2020 rate application. OEB staff further submits that Enbridge Gas should provide details in its 2020 rate application on why a 50/50 sharing of the tax impacts due to the AII program is appropriate to continue. In the event that the OEB establishes a policy specific to this program in advance of the OEB's determination of Enbridge Gas' 2020 rate application, OEB staff expects that parties to that proceeding would address the appropriateness of applying the OEB policy to Enbridge Gas for 2020 rates.

4. Should the following deferral accounts be established?

a) Incremental Capital Module – EGD Rate Zone
b) Incremental Capital Module – Union Gas Rate Zones

Parties agreed to the establishment of the deferral accounts but the question as to whether Operating and Maintenance (O&M) costs and property taxes can be included in the deferral accounts to determine the ICM revenue requirement is disputed.

OEB staff submits that O&M and property taxes should not be included. The OEB's ICM policy does not provide for the recovery of incremental O&M or property taxes through the ICM.[11]

The OEB has never made an exception to the ICM policy for O&M or property taxes. In a recent decision, the OEB approved a request by Halton Hills Hydro incremental capital funding under the ICM in connection with a new transformer station, but denied Halton Hills Hydro's request for the associated O&M costs. The OEB determined that Halton Hills Hydro should be able to manage this incremental amount within its approved revenue requirement.[12] In a case involving Festival Hydro, the OEB suggested that it is open to a utility to request an exception to the ICM policy. But in that

[10] The AII is effective for eligible capital additions acquired after November 20, 2018.
[11] Report of the Board: New Policy Options for the Funding of Capital Investments: The Advanced Capital Module (EB-2014-0219), September 18, 2014; Report of the OEB; New Policy Options for the Funding of Capital Investments: Supplemental Report (EB-2014-0219), January 22, 2016.
[12] Decision and Rate Order, EB-2018-0328. Halton Hills Hydro has filed an appeal with the Divisional Court.

case, Festival Hydro had not done so before incurring O&M expenses associated with an approved ICM project, and so its request for after-the-fact recovery of those expenses was denied:

> … the ICM process approved by the OEB does not contemplate approval of incremental OM&A expenses associated with the new asset. If Festival had considered that these incremental expenses should be approved nonetheless, it could have sought an exception to the general policy in the ICM process as part of its 2013 rates application in the timeframe when the costs were incurred. To approve these 2013 and 2014 expenses at this point would amount to retroactive ratemaking.[13]

The onus is on the applicant to make its case and on the question of whether to grant an exception to the ICM policy, in OEB staff's view, Enbridge Gas has not done so.

Enbridge Gas does not provide any reasons for making an exception to the policy. In fact, the Argument-in-Chief is silent on the question of whether the O&M and property taxes should be included.

When asked at the technical conference why these costs should be tracked in the ICM deferral accounts, Enbridge Gas expressed the view that the property taxes and incremental O&M are a direct result of capital and should be viewed in conjunction with that capital spending.[14] But that answer on its own does not support a deviation from the policy.

In OEB staff's view, the logic underpinning the ICM policy does not extend to recovery of O&M costs. If a project replaces an old deteriorating natural gas pipeline, the new pipeline could significantly reduce maintenance costs overall. Moreover, pipeline expansions or extensions that enable the connection of new customers will normally result in higher revenues from base rates, which can be used to fund any incremental O&M and property taxes. Just as the ICM policy does not contemplate a reduction in O&M costs for ICM projects that replaces old infrastructure, there is no accommodation in the policy to include incremental O&M costs related to a project.

Another reason for denying Enbridge Gas' request to track incremental O&M costs and property tax costs for future disposition is that Enbridge Gas has not given any indication of what those costs may amount to. Enbridge Gas has confirmed that it is not seeking any incremental O&M costs (or property tax costs) as part of the ICM funding request for 2019 rates.[15] The wording in the deferral account is intended to capture future capital projects that may give rise to incremental O&M costs or property tax costs.

[13] Decision and Order, EB-2014-0073, April 30, 2015, p.16
[14] Technical Conference transcript, Volume 1, May 1, 2019, pg.96
[15] Exhibit B1, Tab 2, Schedule 1, p.30

At the technical conference, Enbridge Gas clarified that the request was meant to cover material incremental operating expenses for projects like replacement of compressor stations where the incremental O&M constitutes a significant component of the revenue requirement.[16] However, Enbridge Gas has not explained what would constitute a material incremental O&M cost whereas the ICM policy sets out the requirement to specify the nature of the capital project that requires incremental funding and to fully estimate the associated revenue requirement. Costs that are indeterminate in nature and/or quantum should not be approved as part of an ICM request.

5. Should the proposed changes be made to the accounting orders for the following deferral accounts?

   EGD Rate Zone

   a. 179.24 Post Retirement True-up Variance Account
   b. 179.48 Open Bill Revenue Variance Account
   c. 179.08 Ex-Franchise Third Party Billing Services Deferral Account
   d. 179.70 Purchased Gas Variance Account
   e. 179.88 Storage and Transportation Deferral Account
   f. 179.94 OEB Cost Assessment Variance Account

   Union Gas Rate Zones

   g. 179-136 Parkway West Project Costs
   h. 179-137 Brantford-Kirkwall/Parkway D Project Costs
   i. 179-142 Lobo C Compressor/Hamilton to Milton Project Costs
   j. 179-144 Dawn H/Lobo D/Bright C Compressor Project Costs
   k. 179-149 Burlington Oakville Project Costs
   l. 179-156 Panhandle Reinforcement Project Costs

Apart from the Open Bill Revenue Variance Account, all other existing Enbridge Gas Distribution deferral and variance accounts have been settled. The Open Bill Revenue Variance Account is related to the Open Bill Access (OBA) program proceeding currently before the OEB.[17] In the OBA application, Enbridge Gas requested a two-year extension of the existing financial terms of the OBA program. OBA services allow third parties to access the Enbridge Gas Bill for the purpose of billing charges (such as water heater rental) and for the purpose of distributing third party marketing information in the

[16] Technical Conference transcript, Volume 1, May 1, 2019, pg.115
[17] EB-2018-0319

form of bill inserts. The current rates of Enbridge Gas includes a $5.389 million revenue offset (credit) to recognize net revenues from the OBA program in the Enbridge Gas Distribution rate zone. The Open Bill Revenue Variance Account records any net revenue variances between actual versus forecast revenues and costs.

The OEB does not have any evidence in this proceeding to make a determination on the Open Bill Revenue Variance Account. The approach and the question of whether the variance account should continue will have to be determined in the OBA proceeding. OEB staff submits that the OEB in this proceeding should maintain the status quo and defer to the OBA proceeding panel to make a determination on the Open Bill Revenue Variance Account.

None of the proposed changes to the Union Gas rate zone capital pass-through deferral accounts were settled. The outcome on the proposed changes is tied to the OEB's decision with respect to the proposed one-time capital pass-through base rate adjustment (Issue 7 a) which is discussed below under Issue 7.

6. Should the following deferral and variance accounts be discontinued as proposed?

   a. 179-100 Union North Tolls and Fuel
   b. 179-105 Union North PGVA
   c. 179-103 Unbundled Services Unauthorized Storage Overrun Deferral Account

This issue is settled.

7. Are any rate design proposals appropriate in the context of previous OEB decisions, including:

   a. One-time adjustment for Capital Pass-Through Projects
   b. General service monthly customer charge
   c. Parkway Delivery Obligation adjustment
   d. DSM budget allocation?

This issue was settled except for the one-time adjustment for capital pass-through projects. Enbridge Gas has proposed a one-time adjustment to base rates (a credit of $10.4 million) associated with the capital pass-through projects that were included in

Union Gas' rates during the 2014-2018 Incentive Rate-setting Mechanism (IRM) term. The proposed adjustment represents the difference between the 2018 revenue requirement of $127.6 million included in 2018 rates for the capital pass-through projects and the 2019 forecasted revenue requirement of $117.2 million.[18]

Essentially what Enbridge Gas has proposed is to treat the cumulative revenue requirement associated with the capital pass-through projects from Union Gas' 2014 to 2018 IRM term as a component of rate base and no longer as a Y-factor adjustment.

Enbridge Gas has proposed this one-time adjustment as a result of the MAADs Decision which directed Union Gas to add the rate base and depreciation associated with the capital pass-through projects to the 2013 OEB-approved rate base and depreciation to determine the ICM threshold value for the Union Gas rate zones.[19] According to Enbridge Gas, these changes to the starting point for 2019 rates are required to align the ICM threshold value with the capital investment that can be supported by 2019 rates.

OEB staff understands Enbridge Gas' argument to be that the revenue from rates absent this one-time adjustment (i.e. the inclusion of Union Gas' capital pass-through projects in rate base), would not provide the revenues sufficient to fund the implied ICM threshold value. This is because, absent the one-time adjustment, the Y-factor assets would continue to be trued up in the variance accounts reflecting a declining net book value, and they will continue to not be adjusted for inflation over time. By ceasing the true up of the Y-factor assets, Enbridge Gas is proposing to treat them like other rate base assets whose net book value during an incentive rate-setting period is not updated, but they would also be adjusted up for inflation less productivity.

Enbridge Gas has indicated that by adding the 2019 forecast rate base and depreciation of the capital pass-through projects in the ICM threshold calculation, the 2019 ICM threshold value for the Union Gas rate zones is $80.7 million higher than what rates can support when capital pass-through projects are treated as a Y-factor.[20] The discrepancy according to Enbridge Gas will continue each year during the deferred rebasing period, to a cumulative amount of $410 million by 2023, without the proposed one-time adjustment.[21] According to Enbridge Gas, the one-time adjustment provides base rates with the ability to support the capital spending required by the ICM threshold during the remaining years of the deferred rebasing period.

[18] Exhibit B1, Tab 1, Schedule 1, p.26
[19] EB-2017-0306 / 0307, Decision and Order, August 30, 2018, p.33
[20] OEB Staff IRR#8
[21] Argument-in-chief, p.7

OEB staff does not support this adjustment since the OEB was aware of the construct of the ICM materiality threshold formula, and Enbridge Gas' base rates, at the time of the MAADs decision and made a finding that required the inclusion of the Y factors only to the extent that they impact the materiality threshold formula for the ICM materiality threshold.

In addition, even though the Y factor projects are now proposed to be treated as rate base items, Enbridge Gas has proposed to continue the Y factor deferral accounts for the projects to record the impact of taxes. The capital pass-through revenue requirement proposed for the one-time adjustment includes temporary tax benefits available in 2019 and that are passed through to ratepayers for 2019. Enbridge Gas has identified that there will be higher utility taxes in the remainder of the deferred rebasing period. Absent continuation of the capital pass-through deferral accounts to record utility tax timing differences (i.e. incremental tax payment obligations), the amounts included in rates would not provide sufficient recovery to support capital already invested in the projects, let alone fund incremental capital.[22]

In the MAADs application, Enbridge Gas requested continuation of the capital pass-through deferral accounts. It did not request a different treatment and the OEB approved the status quo and the deferral accounts were approved to continue as is (i.e. to continue recording the revenue requirement as determined in Union Gas' 2014 to 2018 IRM rate framework proceeding).[23] OEB staff therefore does not support the proposed new scope of the capital pass-through deferral accounts.

Essentially, Enbridge Gas is arguing about two different issues but has argued that they are inextricably linked. OEB staff does not agree. The ICM materiality threshold is a conceptual value that determines a proxy for capital additions that can be funded through existing rates. It is essentially a cash flow test at a snapshot in time. On the other hand, the Y-factor represents an implementation mechanism as part of an incentive rate-making framework to recover revenues on items approved by the OEB but not included in base rates.[24] The OEB did not direct Union Gas to add rate base and depreciation related to the capital pass-through projects to rates but only to include them to calculate the rate base to depreciation ratio that is at the heart of the ICM materiality threshold calculation. For rates purposes and revenue recovery, the OEB allowed the Y-factor mechanism to continue to be used for these Y-factor projects.

[22] *Ibid*, p.8
[23] EB-2013-0202
[24] In essence, under Union Gas' previous IRM plan, the Y-factor was analogous to the ICM or the C-factor, in some Custom IR plans, used for electricity distributors.

The capital pass-through projects completed by Union Gas during its IRM period represented large discrete projects to accommodate growth. The load growth associated with those projects provides the incremental revenue that is available to fund capital additions during the deferred rebasing period. Enbridge Gas' argument that in the absence of changing the treatment of the deferral accounts as proposed, its rates cannot support the required level of incremental capital investment prior to ICM funding is not entirely correct. The relationship between revenues from rates and the ICM threshold is not intended to be perfect. The ICM threshold merely indicates what the OEB finds to be a reasonable level of capital expenditures that can be funded through rates during the incentive rate-setting period.

Alternatively, if the argument of Enbridge Gas for an adjustment to the starting point for 2019 rates is accepted, then the capital pass-through deferral accounts should be discontinued since these projects would now be treated like ordinary rate base items. If Enbridge Gas would have rebased, the capital pass-through accounts would have been discontinued.

8. Are there any necessary rate schedule changes, and if so, are the changes appropriate?

This issue is settled.

9. Do the USP and AMPs support approval of the ICMs?

In support of its ICM requests, Enbridge Gas filed a consolidated Utility System Plan (USP) and separate Asset Management Plans (AMPs) for the Enbridge Gas Distribution and Union Gas rate zones. Enbridge Gas confirmed that the USP and AMPs were developed in accordance with the *OEB's Filing Requirements for Natural Gas Rate Applications* and are in alignment with the OEB's Renewed Regulatory Framework. Enbridge Gas explains that the company's capital budget process ensures that capital is allocated in a way that maximizes the value of life-cycle-based capital while mitigating risk to the lowest practical level.

The starting point for determining the maximum eligible incremental capital is the capital budget and the appropriateness of the budget in support of the ICM request. The total in-service capital forecast for the Enbridge Gas Distribution rate zone is $481.7 million.[25]

[25] Exhibit B1, Tab 2, Schedule 1, p.16

OEB staff has reviewed the USP and AMPs for both rate zones in support of the ICM requests for 2019 rates and with the exception of spending on Information Technology (IT) in 2019, has no other concerns with the forecast capital for 2019. While this is not a cost of service proceeding, OEB staff is of the view that a review to some degree of the reasonableness of the 2019 capital budget is appropriate as it is the starting point of the calculation for the materiality threshold.

Over the 2014 to 2018 period, Enbridge Gas Distribution has spent on an average $24 million annually on IT. This includes replacement of hardware, purchase and upgrade of software and Customer Information System (CIS) replacement. For 2019 rates, Enbridge Gas has forecasted $40 million in spending on IT. The company notes that a significant increase in IT spend from 2018 to 2019 is due to large strategic initiatives including Customer Experience Transformation and CIS hardware replacement. The total spend on Customer Experience Transformation is $7 million for 2019. Other large spending items include CIS Hardware Replacement ($10 million) and HANA software implementation ($6.4 million).

For the Union Gas rate zones, IT spending is forecasted to be approximately $28 million. This includes spending on different software systems. The largest spend is on ConTrax ($11.6 million) which provides billing of Distribution, Storage and Transportation services for large customers. The previous software was outdated and the lifecycle replacement project will finish in 2019.

In response to OEB staff interrogatory #67, Enbridge Gas indicated that it is currently reviewing the IT Business requirements and the process will be completed by the end of 2019. At the technical conference, Enbridge Gas further indicated that the proposed capital spend for 2019 was essential and no spending could be deferred until the review was completed.[26]

OEB staff submits that Enbridge Gas' assertion that no IT spending can be deferred for one year is not convincing. Some software and hardware updates are definitely required as they are outdated or no longer supported by the vendor, but this does not apply to every IT spend. Enbridge Gas intends to spend $7 million on Customer Experience Transformation in 2019. The spending is related to implementing changes to SAP, the Enbridge Gas Distribution extranet and other customer-facing solutions to improve the overall customer experience.[27] The evidence clearly indicates that the program is for enhancing the customer experience and not for providing the necessary customer experience. This implies that a reasonable level of service is being currently provided

[26] Technical Conference, Transcript, Vol. 2, pgs.67-68
[27] Exhibit C1, Tab 1, Schedule 1, pgs.1388-1390

and deferring the spending for a year would not degrade the overall customer experience.

The other project that appears to be discretionary is the HANA Software Implementation. The total spend on this project for 2019 is $6.4 million. The project aims to provide certain capabilities as part of the customer experience road map. The benefits cited include new functionality based on “best run” industry model, increased customer self-serve adoption, budget billing optimization, best-in-class user interface and real-time analytics that support customer segmentation.[28] The project intends to implement additional functionality and does not represent a critical need for 2019.This project could be deferred until the integration review is complete. OEB staff reiterates that it is only a matter of a year before the review is completed.

OEB staff has reviewed all the other proposed IT spending and has no specific concerns. Other projects refer to replacing aging equipment, outdated software or meeting new regulations/safety requirements. OEB staff submits that the two projects for the Enbridge Gas Distribution rate zone referred to above totalling $13.4 million can be deferred until the review is complete.

Accordingly, if the starting point of the 2019 budget of $481.7 million is reduced by $13.4 million, then Enbridge Gas Distribution would not have any available incremental capital funding.[29] However, the original (actual) capital budget could accommodate $13.4 million towards an ICM project if the spending identified by OEB staff is deferred.

10. Are the costs of the ICM projects appropriate, to the extent that they differ from the costs considered by the OEB in granting leave to construct?

This issue refers to the variance between the amount approved for each of the proposed ICM projects in the corresponding leave to construct applications and the revised budgeted amount as filed in this application. The submission on this issue is discussed in the issues that deal with the individual ICM projects.

11. Is the NPS 30 Don River Replacement Project in the EGD rate zone eligible for Incremental Capital Module (ICM) funding?

[28] Exhibit C1, Tab 1, Schedule 1, pgs.1411-1413
[29] Revised in-service capital $468.3 million minus materiality threshold value of $468.5 million = -$0.2 million

a. If yes, is the ICM rate rider for the NPS 30 Don River Replacement Project calculated appropriately?

In the MAADs Decision, the OEB confirmed the availability of ICM funding for Enbridge Gas. As set out in the OEB's ICM Policy, the ICM is a funding mechanism available to distributors whose rates are established under a Price Cap IR regime.[30] The ICM policy does not make ICM funding available for typical annual capital programs.[31] The funding is available for discrete capital projects that are material and have a significant influence on the operations of a distributor.[32] The ICM is intended to address the treatment of a distributor's capital investment needs that arise during the Price Cap IR rate-setting plan which are incremental to a materiality threshold.

The OEB's ICM materiality threshold calculation results in a 2019 threshold value of $468.5 million for the Enbridge Gas Distribution rate zone.[33] The maximum eligible incremental capital for the Enbridge Gas Distribution rate zone is $13.1 million and accordingly Enbridge Gas is seeking this amount for the Don River Replacement project. The budget for the Don River Replacement project is $35.4 million and the in-service date is December 2019. The project will replace 0.25 km of nominal pipe size (NPS) 30 XHP on the Don River crossing with a new NPS 30 XHP under the Don River through the use of trenchless technology. The project was granted leave to construct in November 2018.[34]

The original capital cost approved in the leave to construct application was $25.6 million which has been revised to $35.4 million in this application. The primary driver of the variance of approximately $9.4 million is indirect overheads. Although the company provided some clarification on the overheads at the technical conference, it is not clear why the indirect overheads constitute 36.4% of the total cost of the project; especially considering that indirect overheads include support functions such as finance, regulatory etc. and not direct labour. In response to an undertaking, Enbridge Gas indicated that the allocation factor of indirect overheads for the Union Gas rate zone is 14.8% while for the Enbridge Gas Distribution rate zone it is 36.4%.[35] If the Enbridge Gas Distribution rate zone were to use the same allocation factor as Union Gas, the indirect overheads would be $3.86 million.[36] However, as discussed below, OEB staff

[30] Report of the Board: New Policy Options for the Funding of Capital Investments: The Advanced Capital Module, EB-2014-0129, September 18, 2014.
[31] *Ibid*, p.13
[32] *Ibid*, pgs. 8-13
[33] Exhibit B1, Tab 2, Schedule 1, p.10
[34] EB-2018-0108
[35] Response to Undertaking JT1.7
[36] As per EP IRR#16, (35,354,881-9,230,358)X14.8%

believes that the project does not qualify for ICM funding and therefore a detailed discussion on the variance is not warranted.

Of the total budgeted amount of $35.4 million, Enbridge Gas is seeking $13.1 million in ICM funding for the Don River Project. If the OEB accepts staff's position on IT spending explained earlier, Enbridge Gas does not have $13.1 million in incremental capital funding available to cover this project, or put another way, the $13.1 million is covered by the $13.4 million in IT spending that could be deferred until Enbridge Gas completes its review on IT infrastructure by the end of 2019. Accordingly, the project would not qualify for ICM funding.

12. Are the Sudbury Replacement Project in the Union North rate zone and the Kingsville Transmission Reinforcement and Stratford Reinforcement projects in the Union South rate zone eligible for ICM funding?

    a. If yes, are the ICM rate riders for the Sudbury, Kingsville and Stratford projects calculated appropriately?

<u>Sudbury Replacement Project</u>

The three projects referenced above are proposed in the Union Gas rate zones. The first project is the Sudbury Replacement Project. The project replaced 20 km of NPS 12 pipeline in the Sudbury area. The total cost of the project as approved in the leave to construct application was $74.1 million.[37] The actual cost of the project was $95.3 million and the project went in service in October 2018. Although the project went in service in 2018, Enbridge Gas has requested ICM eligibility for 2019 rates. The project would have qualified for Union Gas' capital pass-through mechanism under its previous IRM framework. However, since it went into service in October 2018, it could not be included in time for recovery in 2018 rates.

The project does not qualify for ICM funding in OEB staff's view as the ICM funding policy contemplates forecasted in service projects for the rate year that is being applied for.[38] The policy does not speak to projects that have already gone into service in a prior year, and whether they should be treated as ICMs for purposes of commencing rate recovery on a going forward basis.

[37] EB-2017-0180
[38] Funding shall not commence for any projects that are not forecasted to be in-service during the subject IR year. Report of the Board: New Policy Options for the Funding of Capital Investments, EB-2014-0129, September 18, 2014, p.13

This is a unique case where a project falls between a previous capital funding mechanism and the incremental rate treatment under the ICM. In its evidence, Enbridge Gas noted that delaying the leave to construct application was not an option and if the project was delayed, integrity concerns could have become more serious. Given the magnitude of the investment, Enbridge Gas has indicated that incremental funding is required. The cumulative revenue requirement of the project from 2018 through 2023 is over $47 million.[39]

Given the unique circumstances in this case, OEB staff is of the opinion that Enbridge Gas should be eligible for recovery of the revenue requirement related to the project. However, it is clear that it does not qualify under the OEB's ICM policy as it did not go into service in the rate year (2019). But more importantly for OEB staff, this is a transitional matter that should recognize the framework that was in place at the time the project was approved for construction, and placed into service.

Since the project went into service in 2018 and at that time Union Gas had access to the capital pass-through mechanism, OEB staff submits that the capital pass-through mechanism should apply and Enbridge Gas should be granted the appropriate deferral account to track and recover the revenue requirement related to the project. The capital pass-through account would be a Y-factor and operate like the other Union Gas capital pass-through deferral accounts. However, since no deferral account for this project existed in 2018, the new deferral account should include the net book value of the asset as of January 1, 2019, the effective date of interim rates. Enbridge Gas is requested in reply to confirm the capital cost that would be used to calculate the revenue requirement in the deferral account for 2019.

The second issue is the difference between actual and approved costs. While the leave to construct application approved a budget of $74.1 million, the actual cost was $95.3 million. Enbridge Gas has indicated that the variance is attributed to the inclusion of indirect overhead costs and increase in contractor costs. At the technical conference, the applicant clarified that the leave to construct application only included incremental costs and not the fully burdened costs.[40] The Sudbury project includes $12.3 million in indirect overhead costs. OEB staff accepts the explanation of Enbridge Gas with respect to the variance and has no concerns with the actual costs incurred or the calculation of the rate rider. OEB staff further notes that while the allocation factor of indirect overheads for the Enbridge Gas Distribution rate zone is 36.4%, the allocation factor of indirect overheads for the Union Gas rate zone (which applies in this case) is 14.8%.[41]

[39] Argument-in-chief, p.17
[40] Transcript Vol. 1, p.52
[41] Response to Undertaking JT1.7

Kingsville Reinforcement Project

This project involves building a 19 km transmission pipeline in the County of Essex at a cost of $121.4 million. The project is required to serve the increasing natural gas demand in the Kingsville-Leamington market as well as increasing demand on the overall Panhandle Transmission System. The project in-service date is November 2019. The OEB approved the pipeline in September 2018 and determined that the pipeline was in the public interest.[42] The original capital cost approved in the leave to construct application was $105.7 million. The total ICM funding request for this project is $118.2 million.[43]

This is a discrete project with a significant capital outlay when compared to the total 2019 capital budget of Enbridge Gas.[44] OEB staff is of the opinion that the project qualifies for ICM funding. It is a significant project that addresses growth and reinforces a transmission system.

An additional issue is the variance between the original budget approved in the leave to construct application and the revised budget. The entire increase in the budget is attributed to indirect overhead costs.[45] As noted earlier, Enbridge Gas clarified at the technical conference that the leave to construct application only included incremental costs and not fully burdened costs which includes indirect overheads.[46] OEB staff accepts the explanation for the variance and once again notes that this is a Union Gas rate zone project with an indirect overheads allocation of 14.8%.

The Kingsville Reinforcement Project is expected to go in-service in 2019 and will have a credit balance with respect to the revenue requirement in 2019. In the first calendar year of a project's in-service date, the revenue requirement may be a credit balance due to utility timing differences associated with the difference between utility income and taxable income. To reduce volatility in the impact to customers resulting from credit balances in the revenue requirement, Enbridge Gas has proposed to net the credit balance in the in-service year with the balance in the second year and defer the ICM refund until the second year of the project. Enbridge Gas has made this proposal to maintain stable predictable rate impacts during the deferred rebasing period. OEB staff understands the intention of Enbridge Gas to reduce volatility in terms of having a credit

[42] EB-2018-0013
[43] Exhibit B1, Tab 2, Schedule 1, p.18
[44] $121.4 million of 1,056 million (11.5%)
[45] Energy Probe IRR#16
[46] Transcript Vol. 1, p.52

balance in the first year and then a debit balance. However, OEB staff prefers that the revenue requirement impact related to all ICM projects should be included in rates for that year. This is the appropriate ratemaking approach and administratively simple as it does not require the OEB to revisit past balances. Accordingly, Enbridge Gas is requested to provide the 2019 rate riders for the Kingsville Reinforcement Project in reply.

Stratford Reinforcement Project

This project involves construction of 10.8 kms of NPS 12 pipeline and ancillary facilities in order to increase the capacity of Forest, Hensall and Goderich Transmission System serving the northern portions of the Counties of Middlesex and Lambton, and the Counties of Perth and Huron. The estimated cost of the project is $28.5 million and the projected in-service date is November 2019. The OEB granted leave to construct in March 2019.[47] The ICM funding request for this project is $25.1 million.[48]

In an earlier discussion, OEB staff noted that the PCI used for the Union Gas rate zones threshold calculation is 0.72% which is the average of the actual annual PCI used to increase rates during its price cap plan as compared to the 2019 PCI of 1.07%. OEB staff has argued that the recent PCI should be used for the threshold calculation. If this argument is accepted, the materiality threshold value for the Union Gas rate zone increases from $375.2 million to $398.5 million.[49] The Maximum Eligible Incremental Capital would drop from $143.3 million to $120 million which would be mostly exhausted by the Kingsville Reinforcement Project that requires $118.2 million of ICM funding. The remaining $1.8 million in OEB staff's view can be easily absorbed by the utility within its existing capital budget.

In the Toronto Hydro Electric Systems Ltd.'s three year application for 2012 to 2014 rates.[50] The OEB in its decision regarding the application for ICM funding noted: "the Board does not expect that projects that are minor expenditures in comparison to the overall budget should be considered eligible for ICM treatment. A certain degree of project expenditure over and above the threshold calculation is expected to be absorbed within the total capital budget".[51]

The project is a regular distribution growth project that is intended to serve specific communities. Enbridge Gas completes several projects in a given year to reinforce or respond to growth in specific communities across Ontario. The Stratford Reinforcement

[47] EB-2018-0306
[48] Exhbit B1, Tab 2, Schedule 1, p.18
[49] LPMA IRR#11

Project is a normal distribution system project to serve load growth. The OEB's Capital Funding Policy States:

> The Board is of the view that projects proposed for incremental capital funding during the IR term must be discrete projects, and not part of typical annual capital programs. This would apply to both ACMs and ICMs going forward.[52]

The ICM was not intended to be a "capital budget top-up" and not all capital spending up to the maximum eligible incremental capital is eligible for incremental funding. OEB staff is of the view that the Stratford Reinforcement Project can be absorbed within the total capital budget of Enbridge Gas and considering that the project would be categorized as normal course of business, it does not qualify for ICM funding.

13. Is Enbridge Gas' customer connection policy and Profitability Index calculation for consumers appropriate and in accordance with OEB guidelines?

In its earlier customer connection policy, Enbridge Gas Distribution provided a threshold of 20 metres for standard residential service connections and customers were required to pay the appropriate contribution in aid of construction (CIAC) when the service length exceeded the threshold.[53] In its argument-in-chief, Enbridge Gas has noted that the CIAC amount was determined at a rate of $32 per additional metre as prescribed in Rider G of the Rate Handbook.[54]

Since August 2015, Enbridge Gas refined its approach to determine the Profitability Index (PI) for each infill customer. The CIAC amount for residential infill customers is now determined by individually estimating the revenue allowance and the service cost estimate, which is typically a regionally tailored estimate based on historical data from similar services in the same area. The amount of service cost in excess of the revenue allowance is the CIAC amount which is recovered from customers before service installation. The PI of each customer connection is brought to 1.0 under this scenario. A PI of 1.0 would mean that the projected revenues over a certain number of years on a Net Present Value basis are equal to the project costs. In other words, Enbridge Gas Distribution no longer provides a free threshold of 20 metres and the PI is calculated for each infill customer based on costs and revenues in the same area. This approach was

[52] Report of the Board: New Policy Options for the Funding of Capital Investments, EB-2014-0129, September 18, 2014, p.13, section 4.1.1
[53] Response to staff interrogatory #3, EB-2018-0131
[54] Argument-in-Chief, p.19

not reflected in the Enbridge Gas Distribution Rate Handbook or the Conditions of Service filed as part of the 2015 rates application.

OEB staff in its submission on the Issues List argued that the changes implemented by Enbridge Gas had not been examined by the OEB in any proceeding and therefore the change in customer connection policy should be an issue in this proceeding. Enbridge Gas in reply did not object and the OEB agreed to review the issue in this proceeding.

At the technical conference, Enbridge Gas referred to Energy Probe IR#25 that shows the Investment Portfolio falling below 1.0 in 2015 and fairly close to 1.0 in 2014 and 2016. The Investment Portfolio represents the PI of all distribution customers who are expected to attach in a particular year. Enbridge Gas has submitted that the change in the customer connection policy was required to ensure that the company's Investment Portfolio achieves a PI of greater than 1.0.

In response to an undertaking, Enbridge Gas estimated the annual additional revenue as a result of the change in the customer connection policy to be $8 million per year.[55] In other words, from August 2015 to August 2019, the company is expected to earn an additional $32 million.

Enbridge Gas Distribution implemented the changes during its Custom IR period and the revised policy was not examined by the OEB in any proceeding. In Enbridge Gas Distribution's 2016 annual rate adjustment proceeding, it did include the revised policy in the Conditions of Service but did not explicitly identify this change or request approval for the change.[56] The change was not identified in the list of requested approvals nor was there any rationale or evidence to support the change.

Enbridge Gas Distribution's existing rate structure was set on a cost of service basis in 2014, prior to the implementation of the new policy. The current rates of Enbridge Gas Distribution therefore underpin the costs to connect customers under the previous policy. The fact that the Investment Portfolio dipped below 1.0 in a particular year is not a sufficient reason to unilaterally change the policy. Enbridge Gas should have waited before implementing changes, either for OEB approval in a cost of service proceeding or to assess whether the dip is of a temporary nature. In its argument-in-chief, Enbridge Gas refers to Rider G of the Rate Handbook that provides a rate of $32 per additional metre. It is not clear whether this charge still applies (now without including any free threshold) or if the connection charges are now based on a different calculation.

[55] Undertaking JT1.11
[56] EB-2015-0114

In response to an interrogatory, Enbridge Gas has noted that the modified approach was adopted to comply with the EBO 188 regulation and ensure that economically feasible customers are attached to the system. If uneconomical customers are attached, Enbridge Gas noted that utility earnings will be negatively impacted until rebasing.[57] OEB staff does not agree with this argument.

The average actual return on equity (ROE) for the Enbridge Gas Distribution rate zone for the period 2015 to 2018 is 10.07% while the average OEB-approved ROE for the same period is 9.07%.[58] Based on the response to an interrogatory, OEB staff has estimated a 16 to 18 basis points impact on revenues of $8 million.[59] In other words, had Enbridge Gas not changed its customer connection policy, Enbridge Gas would still have earned above the OEB-approved ROE. In addition, there are other activities that may have an impact, positively or negatively on utility earnings that are not typically addressed or trued up over the course of an incentive rate-setting term.[60]

OEB staff sees no reason for Enbridge Gas to have implemented a revised approach to its customer connection policy without an OEB review. OEB staff therefore submits that Enbridge Gas should be required to revert back to the previous customer connection policy on a going forward basis until such time as its revised approach is reviewed by the OEB in a cost-based application.

- All of which is respectfully submitted -

[57] Staff IRR#2
[58] BOMA IRR#38
[59] APPrO IRR# 2(f) – after tax revenue impact of $7.2 million results in a reduction of 14 to 15 basis points in the ROE.
[60] Changes in macroeconomic conditions, that affect economic activity in the utility's service area, or the rate of growth in residential and commercial customers accelerating or delaying system expansion or reinforcement, can alter the timing and quanta of costs for capital and operating programs and of specific projects. The utility is expected to manage its costs in accordance with actual conditions, which will vary, for exogenous reasons, from the forecasts on which the utility's plan and budget is based. Under incentive rate-setting, it is particularly the expectation that the utility will manage its operating and capital costs in accordance with serving customers' needs and expectations as they occur and in consideration of the approved price levels, including the allowed rate adjustment formula.