



By EMAIL and RESS

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Our File: EB20200181

Ontario Energy Board
2300 Yonge Street
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Attn: Christine Long, Registrar

Dear Ms. Long:

Re: EB-2020-0181 – Enbridge 2021 ICM – SEC Final Argument

We are counsel to the School Energy Coalition ("SEC"). Pursuant to Procedural Order #4 in this proceeding, this constitutes the Final Argument of SEC in this matter.

Introduction and Summary

1. The history of this proceeding is set out in POs #3 and #4, and we will not repeat it here. This is the Final Argument of SEC. In preparing these submissions, we have benefitted from co-operation with other parties, including sharing drafts and positions on various issues. In particular, we benefitted from other parties stepping in to ask questions at the Technical Conference when SEC was unable to attend due to a conflict with another OEB proceeding on the same day.
2. ***Issues Addressed in this Final Argument.*** These Submissions deal with the following issues:
 - 2.1. Lack of justification of the Capital Budget, including in particular
 - 2.1.1. The extent to which that budget appears to be driven by the goal of qualifying ICM projects,
 - 2.1.2. Failure to justify the large increase in capital spending from pre-2021 to the current year,
 - 2.1.3. The claims of a rigorous value and prioritization exercise, which do not appear to be fully supported by the evidence, and

- 2.1.4. Past over-forecasting of the capital budget, thus increasing the maximum ICM capital in the past.
- 2.2. Obvious and concerning flaws in the Asset Management Plan and the Utility System Plan it supports.
- 2.3. Inappropriate double counting of OM&A in base rates and in 2021 capitalized OM&A.
- 2.4. A change in capitalization policy that appears to result in an increase in the capital budget relative to the ICM threshold, and on which the OEB has insufficient evidence to reach conclusions on the amounts in issue.
- 2.5. Non-compliance with the Filing Requirements, leading to late discovery during the proceeding that the Sarnia Project does not qualify for ICM treatment under the OEB's ICM guidelines.
3. **Issues Not Addressed.** Because of our positions on the general issues, we have not provided specific submissions on the London Lines Project (except to note our agreement with the submissions of LPMA on cost allocation if it is approved). We have relied other parties to make submissions in that regard. Where we do not comment on any particular issue, that is not intended to be acceptance of the Application, or agreement with any other party unless expressly so stated. Silence is just silence.
4. **Overall SEC Recommendation.** SEC submits that the Applicant's request for ICM treatment for the two projects should be denied in its entirety, for the reasons set forth in this Final Argument, and the submissions of other parties on issues not dealt with by SEC.

The Base Capital Budget Has Not Been Justified

5. **Goal of the Capital Budget Process.** The Applicant describes the process of developing the 2021 capital budget presented to the OEB in this proceeding as follows¹:

"..The Applicant determined the capital constraint for 2021 by calculating the ICM Materiality Threshold for that year, and then has escalated that amount by a forecast growth factor to estimate the capital constraint for 2022-2025. The Applicant then optimizes its capital projects to the capital constraint for each year. If the optimization fails due to the level of fixed and mandatory projects, the Applicant identifies projects that it believes would qualify for ICM treatment under the Board's rules, that are likely causing the optimization failure. The optimization is rerun until an optimized result is achieved, providing Enbridge Gas with the best understanding of an optimized base spend profile. The ICM-eligible investments

¹ I.SEC.1(a). We note that in the Technical Conference the witnesses tried to say that the process included delaying projects and other optimization activities, but then came back to the basic approach later, saying [Tr:106]:

"MS. McCOWAN: Right. So I think we also talked about the idea that we take out the ICM-eligible projects as we are going through that optimization exercise, because you can't make it -- you can't make them fit. And so the London Lines would be one that we pulled out initially in order to get a result through the optimization, and then those projects are layered back in afterwards."

are brought back into the plan after optimization. Those projects may then be included in an ICM application with respect to the year they are expected to be in service.”

6. Thus, the Base Capital Budget is filled up with projects, with certain ICM projects kept out of the budget. Once the budget is “optimized”, the Applicant then identifies ICM projects for which it will seek additional rate increases. The Applicant has identified ICM projects in excess of Base Capital Budget for all years in the Union rate zone, and in three of the five years in the EGD rate zone².
7. Note that there is no limit actually placed on the reasonableness of the capital budget³, nor the rate impacts of the capital spending⁴. The only limit is how much the Applicant can physically get done, through its own personnel, or contractors, during the year⁵.
8. SEC submits that this is nothing more than gaming the OEB’s ICM guidelines. It proceeds on the premise that the utility is entitled to bring capital in-service up to the ICM Materiality Threshold as of right, and there is no scrutiny of that spending. Then, if they have ICM type projects, they can get extra rate increases for those projects, and the overall reasonableness of their capital budgets during IRM will never be reviewed.
9. SEC does not believe this is consistent with the OEB’s policies. The intent of the ICM is to give utilities a relief valve where reasonable capital spending requirements sometimes exceed the amounts funded in base rates. The intent of the ICM is not to set a floor capital spending level, which can be exceeded every year as long as a few large, discrete projects can be set aside for separate funding. This is a misuse of the Incremental Capital Module, and in our submission the OEB should reject this approach clearly, so that Enbridge Gas and all other utilities understand that it is not acceptable.
10. SEC therefore submits that the capital budget the Applicant has proposed in this proceeding is based on a faulty premise, and that premise should be rejected by the OEB. Instead, the OEB should look at whether the overall capital spending proposal of the Applicant is reasonable in the circumstances.
11. SEC submits that it is not.
12. **The Increase in the Capital Budget.** Enbridge Gas is proposing a 23.2% increase in their capital budget from 2020 to 2021⁶. Their explanation of that increase is that their new approach to assessing capital spending needs has identified many more requirements, particularly in the area of system renewal. This is largely driven by the merger, in that new approaches already developed by EGD are now being applied to the Union Gas assets⁷.

² I.SEC.1(b)

³ Tr:31.

⁴ Tr:43-5.

⁵ Tr:39.

⁶ I.SEC.33, p. 2. The increase from 2020 to 2021 is \$239.4 million, after including all overheads. Both 2020 and 2021 include the new capitalization policy, so the comparison is apples to apples, and the change in overhead policy does not appear to have any impact on the percentage increase.

⁷ Tr:14, 15, 49 and many other places.

13. If that is in fact the reason for the large increase in capital spending, SEC submits that the increase should not be accepted by the OEB. There are situations in which capital spending should increase (or decrease), particularly after a new asset condition assessment, but where that is the case approval of such an increase should be accompanied by a thorough regulatory review of the new Utility System Plan that is justifying that increase.
14. As the OEB has pointed out in this proceeding⁸, that happens on rebasing, and in our view that is the time for the OEB to consider whether a step change in capital spending is warranted. It is submitted that it is not appropriate to allow a \$239.4 million permanent increase in capital spending over one year without a complete review of the long term capital plan.
15. SEC does note, however, that an alternative explanation of the increase from 2020 to 2021 is that 2021 includes the two ICM projects, on the theory that if that \$155.5 million of “incremental” spending is set aside, the increase in capital spending is only 8.1%.
16. If that is in fact the real rationale for the increase, SEC has three comments:
 - 16.1. 8.1% is still a much higher increase in spending that would normally be expected in a business as usual situation.
 - 16.2. In each of the subsequent years, the Applicant plans to have “incremental” projects, meaning that the ratepayers never actually see business as usual capital spending.
 - 16.3. Normally a utility with large capital projects is expected to make some room in its budget for those projects by limiting or deferring other capital, but in this case it is clear that these two projects are simply treated as an entitlement to extra rate funding.
17. In our submission, ICM projects only qualify to the extent that they are part of a reasonable capital budget. That requires the Applicant to provide evidence to the effect that the entire capital budget is reasonable, not just the two projects for which ICM funding is sought. It is not appropriate for the Applicant to say that the Base Capital Budget is out of scope, or should be assumed to be OK. ICM projects are only incremental to the extent that they are built on a reasonable foundation of spending, and that requires evidence.
18. SEC therefore submits that, on the evidence in this proceeding, the Applicant has not demonstrated that the increase in its capital budget is justified, and because the USP and AMP are not being reviewed in full, they do not assist the Applicant in justifying that increase. The only justification of the increase actually given – “we have now looked more closely at the condition of the Union assets” – appears to be a merger-driven change that is more appropriately reviewed by the OEB at rebasing.
19. **Value Optimization.** Enbridge Gas alleges that it uses a “value optimization” process⁹ to determine what capital projects should be selected for implementation in any given year, including 2021.

⁸ Procedural Order #3, p. 4.

⁹ E. C/2/1, p65-6.

20. It turns out, however, that this is not entirely correct, at least not for 2021.
21. For example, neither the London Lines Project¹⁰ nor the Sarnia Project¹¹ were included in the value optimization process. Neither were many other projects¹², including any projects deemed mandatory, or any projects justified through EB188 or EBO134¹³, in fact most of the project portfolio. In addition, the witnesses made clear that even with the few projects that were run through that process *“there’s some aspects of project value that we don’t believe are being fully understood through our value assessment”*¹⁴.
22. In fact, the gaps in the value optimization in 2021 were so material that Enbridge Gas expressly refused to provide the results to the OEB, as *“the total value is not going to be indicative of anything”*.
23. That is, although the prefiled evidence of the Applicant said that through the value optimization process the company maximizes the value of the capital portfolio for the year, that is not in fact true to for the year the OEB is currently considering.
24. SEC therefore submits that the OEB cannot rely on the Applicant having carried out any rigorous prioritization and optimization process to justify the capital budget being presented to the Board. No such process happened in fact, and any indication to the contrary in the prefiled evidence should not be so interpreted.
- 25. Past Overforecasting of In-Service Capital.** SEC has had an opportunity to review the submissions of LPMA, which discusses in detail past overforecasting of in-service capital of \$10.7 million in 2019 relative to the figure approved by the Board for ICM purposes, and \$32.1 million in that same year relative to the figure reported by Enbridge Gas after the 2019 was over¹⁵.
26. SEC agrees with LPMA that the forecasts of capital spend cannot be relied on by the OEB. However, we believe the appropriate solution in light of all the other problems with the capital budget is to deny ICM funding for both proposed projects, as the Applicant has not demonstrated that the projects are incremental to a reasonable capital spending plan.

The Utility System Plan and the Asset Management Plan are Not Credible

27. The OEB will be aware that SEC and others are, in the EB-2020-0091 Enbridge IRP proceeding, challenging the appropriateness of the capital planning approach being used by Enbridge Gas. Those challenges are based primarily on two related components:
- 27.1. **Growth Assumptions.** Enbridge Gas assumes that its customer numbers and demand will continue to grow indefinitely into the future, and will not be constrained by a

¹⁰ Tr:56-7.

¹¹ Tr:117.

¹² Tr:101.

¹³ Tr:118.

¹⁴ Tr:105.

¹⁵ See I.LPMA.2.

lower carbon future¹⁶.

- 27.2. **Price of Carbon.** Despite the expectation that the price of carbon will move to \$170 a tonne, which will impact the Enbridge Gas capital needs in the future¹⁷, Enbridge Gas insists on retaining the assumption that the price of carbon will get to \$50 a tonne, and then increase only with inflation, indefinitely into the future¹⁸.
28. The current AMP and USP are based on these clearly incorrect assumptions, and in the submission of SEC the result is that the Applicant is over-forecasting the need for additional capital spending on its system. It is basically building stranded assets, and asking for extra rate increases to do so.
29. While SEC agrees that it would not be efficient to try to re-hash the arguments over proper long term capital planning in this ICM proceeding, especially since some of the issues will be dealt with in EB-2020-0091, and some will almost certainly be centre stage in the upcoming rebasing proceeding for the merged Enbridge Gas.
30. The Board, however, is faced with what to do in the meantime.
31. SEC believes that the appropriate response of the OEB is to place a pause on incremental capital spending requests from Enbridge Gas, until such time as the Board can consider the future capital needs of the gas utility in full, which is at rebasing. Until that time, in our submission the OEB should not approve incremental capital spending except where it can be demonstrated that the spending is uniquely different from the normal capital spending of the Applicant.

Capitalized OM&A Should Not be Double Counted in ICM Projects

32. **The Problem.** SEC has long believed that capitalizing OM&A in an ICM project is double counting, and should not be permitted. In our view, capitalizing OM&A in a rebasing application is fundamentally different from an ICM application.
33. In a rebasing application, there is a full range of spending considered, and all OM&A spending, whether direct or indirect, and whether overheads or allocation of personnel and equipment between capital and operations, is considered and allocated to only one place. There is no double counting. It is allocated to operations or capital. No overlap.
34. In an ICM application, there is a proposed allocation of OM&A spending to capital projects (in base capital and in ICM projects), but there is no balancing component where only the remaining OM&A is included as operating costs in rates. A normally symmetrical process is changed to an asymmetrical process. This is what creates the double counting¹⁹.
35. **Potential Solutions.** Despite the obvious potential for double counting, it is true that some

¹⁶ Enbridge Gas has refused to confirm this, saying the question is irrelevant (I.SEC.6(c)), but has admitted it without reservation in EB-2020-0091. There is no actual dispute over whether this is the Applicant's planning assumption.

¹⁷ Which Enbridge Gas admits: I.SEC.6(f)

¹⁸ I.SEC.6(e)

¹⁹ Indeed, this may be one of the reasons why Enbridge Gas earned \$70.7 million (after tax) above allowed ROE in 2019, equivalent to \$96.2 million before tax.

component of capitalized OM&A should be included in the cost of capital projects, including ICM projects. Not only is this standard utility practice (and proper accounting), but it reflects the fact that, in the last rebasing year, some amount of OM&A was included in capital, so to bring it back to zero in the current year would be unfair to the utility.

36. In SEC's view there are two technically appropriate solutions that the Board could implement to deal with this.
37. First, the OEB could implement the solution proposed by IGUA in its Final Argument. The IGUA solution would allow full OM&A capitalization, but would then reduce rates by the amount of incremental OM&A being capitalized, keeping the ratepayers whole by making the allocation process once again symmetrical. This solves the allocation issue, but it does not take into account that increased capitalization of OM&A will also increase the Base Capital Budget, and thus the total amount of capital that is treated as incremental for ICM purposes.
38. Second, the OEB could escalate the actual amount of capitalized OM&A included in base rates by the IRM and growth factors, in a similar manner to the ICM threshold, to produce an amount of capitalized OM&A that can be included in the current year capital budget for ICM purposes. Under USGAAP, the Applicant would not be allowed to capitalize any additional amount²⁰, so both the utility and the ratepayers would remain whole. It would have the additional advantage that the Base Capital Budget and therefore the eligible ICM amount would be calculated on an apples to apples basis with the previous rebasing year.
39. SEC submits that, separate from the issue of the increase in capitalization (discussed below), one of the above solutions should be implemented so that Enbridge Gas does not collect material amounts of OM&A twice from customers.

The Change in Capitalization Improperly Increases the ICM Qualifying Capital

40. Without OEB approval, the Applicant on January 1, 2020 changed its OM&A capitalization policies and procedures²¹ to increase the amounts of OM&A allocated to capital.
41. As a preliminary matter, SEC notes that this change was done internally, and the Applicant has not provided any independent review of the change, either from an accounting point of view or a regulatory point of view. Indeed, in the only external document on this that the Applicant has filed²², Ernst & Young repeatedly emphasizes that its role was limited to "document[ing] management's rationale..."²³. It gave no opinion, and makes no claims that any of the capitalization policy, or the process to get there, was consistent with any E&Y recommendation or proposal or assessment of appropriateness.
42. The evidence is not clear as to the impacts of the change in capitalization policy. Enbridge Gas admits²⁴ that the result of the change is that an additional amount of OM&A is being capitalized in 2020 and 2021 compared to prior years. What the OEB cannot discern from the evidence is how much that impact is in 2021. There are several competing numbers.

²⁰ See JT1.6, Attach. 1, p. 13 of 25, and particularly ASC 980-340.

²¹ JT1.6 and many other references.

²² JT1.6, Attach 1.

²³ Ibid, p. 4 of 25.

²⁴ Argument in Chief, para. 20.

43. In the Technical Conference, Enbridge said that the total amount credited to the Accounting Policy Changes Deferral Account – the “overall impact” - is \$8 million for 2020²⁵. The Board has no indication of how that was calculated²⁶. SEC has not been able to find an equivalent estimate for 2021.
44. The Applicant has also admitted that, for 2021, the overheads component of the capital costs of the Sarnia Project increased from \$2.9 million to \$5.0 million as a result of this accounting change²⁷, a 72.4% increase. If that is indicative, then since overheads have historically been just over \$200 million a year, and on average about 18% of total capital spend²⁸, that would suggest that the increase in 2021, given the higher capital budget, is more than \$195 million. This would go a long way to explaining the high 2021 capital budget, but would appear to be an unlikely result in the circumstances²⁹.
45. LPMA in their submission notes³⁰ that the capitalized OM&A for the London Lines Project increased by 25.6% as a result of the accounting policy change. If this percentage were applicable to the entire capital budget, the result would be an increase in OM&A capitalization in 2021 of more than \$80 million in a budget of \$1.27 billion³¹.
46. SEC notes further that we have three figures of OM&A capitalization for 2020, and they do not appear to have any connection each to the other. In the E&Y document, the result of the new policy for 2020 is listed as \$253.3 million³². In a response to an SEC interrogatory, the 2020 amount is listed as \$207.8 million³³. In a response to an Energy Probe interrogatory, the 2020 amount is listed as \$241.9 million³⁴.
47. There are other examples that could be used, but the overall point is clear. The OEB has no way of knowing how material the change in OM&A capitalization policy is for 2021 capital spend. The amount claimed by the Applicant, \$8 million, appears to be inconsistent with other evidence before the Board.
48. Further, there is some doubt that simply comparing amounts labelled “overhead” is helpful. By way of example, in the same Energy Probe Interrogatory, which lists 2020 overheads as \$241.9 million, the Applicant says that in 2021, with a much higher budget, overheads are \$210.1 million³⁵.

²⁵ Tr.83. See also I.LPMA.7(c).

²⁶ It does not appear to have been calculated in the same manner as accounts 1575/6, as one would expect, but there does not appear to be any more information than that.

²⁷ I.APPRO.2.

²⁸ I.SEC.32, p. 2.

²⁹ However, the same reference appears to show that there was no change in allocated OM&A from 2019 to 2020 (both 20% of total capital), despite the accounting change starting at the beginning of 2020. No explanation has ever been provided for this apparent anomaly.

³⁰ LPMA Final Argument, p. 6.

³¹ I.SEC.32, p. 2.

³² JT1.6, Attach 1, p. 10 of 25. It is not clear whether this is capital expenditures or in-service additions, and the document does not indicate the size of the increase resulting from the policy, only the resulting dollar totals.

³³ I.SEC.32, p. 2. This is capital expenditures.

³⁴ I.EP.2 (\$140.2+101.7).

³⁵ I.EP.2 (\$96.7+113.4).

49. SEC believes that this lack of comparability is the result of some part of the previous OM&A allocations to capital being embedded in the hard capital costs, rather than identified as overheads, so that past and future numbers are not comparable. If this is true, of course, that means that none of the numbers in the Application are helpful to the OEB in determining this issue.
50. It is not even possible to go under the hood and look at the specific changes to estimate their impacts. In the E&Y document, there is a detailed list of the allocation percentages, which appear to be for 2020³⁶. However, there is no comparative information on the previous allocation percentages, either in that document or anywhere else in the Application³⁷.
51. The problem here is that the ICM Materiality Threshold is calculated on one basis, using historical data, and the proposed 2021 capital budget is calculated on a different basis, using a new accounting policy, and the evidence does not provide sufficient information on the difference. As a result, it is likely that the ICM eligible capital is overstated, and the OEB has no way of knowing how much that overstatement is.
52. SEC believes that the OEB is not in a position to determine, within any level of materiality, the capital budget of Enbridge Gas, or the capital cost of the proposed ICM Projects, in a manner comparable to the past capital spending of the Applicant, and in a manner comparable to the calculation of the ICM materiality threshold. It appears possible that the differences between the current capital budget, and prior capital budgets, are in the tens of millions of dollars as a result of this accounting change.
53. SEC therefore submits that, in addition to the reasons set forth above and below, the OEB should deny approval for ICM Funding of the proposed projects because the evidentiary record on the accounting policy change is insufficient for the Board to make a just and reasonable finding.

The Sarnia Project Does Not Qualify

54. SEC has had an opportunity to review the submissions of OGVG and LPMA with respect to the claim for ICM treatment of the Sarnia Project. SEC adopts those reasons entirely. It is clear that the Sarnia Project does not qualify for ICM treatment.
55. SEC further notes that the Applicant did not comply with the Filing Requirements with respect to its claim for the Sarnia Project. Specifically, the Applicant failed to disclose to the OEB that the revenues from the project will far exceed the revenue requirement of the capital spend. Even if the Applicant planned to take the (incorrect) position that they should be able to collect the cost of this project both from an incremental customer load, and from other ratepayers through an ICM, it is shocking to SEC that the Applicant failed to disclose

³⁶ JT1.6, Attach 1, pp 21-25.

³⁷ In Tr:129, the witnesses tried to be of assistance by referring to EB-2018-0305, OEB STaff IR #32(c), but it turns out that reference does not provide any useful information on the calculation of the OM&A capitalization in the previous methodology. It just lists categories without numbers.

to the Board relevant and material information necessary for the OEB to consider the project, especially since that information is expressly required in the Filing Requirements³⁸.

56. SEC believes that it would be appropriate for the OEB in its decision to comment on this failure to comply with the Filing Requirements, and the implications of that non-disclosure.

Allocation for the London Project

57. SEC has had an opportunity to review the submissions of LPMA with respect to the proposed change in cost allocation for the London Lines Project.
58. In the event that, despite the earlier submissions of SEC in this Final Argument, the Board determines that it will approve all or part of the ICM claim for London Lines, SEC submits that the LPMA argument with respect to cost allocation is correct. There is no justification for changing the cost allocation of this project so that residential customers (and schools) pay a larger share of that cost. This kind of cost allocation change should only be implemented in a rebasing proceeding, where a full cost allocation study can be reviewed by the Board.

Conclusion

59. SEC therefore submits:

59.1. The Board should deny approval for the two ICM projects because

59.1.1. The Capital Budget has not been demonstrated to be reasonable,

59.1.2. The substantial increase in the overall capital budget has not been justified,

59.1.3. The USP and AMP are based on clearly erroneous premises and thus raise a significant risk of future stranded assets, and

59.1.4. The OEB has insufficient evidence on the change in OM&A capitalization to determine the impact of that change on the amount of capital incremental to the ICM materiality threshold, and on the actual capital cost of the proposed ICM projects.

59.2. In the alternative,

59.2.1. The Sarnia Project should be disallowed because it does not qualify for ICM treatment,

59.2.2. The amount of eligible capital should be adjusted to take into account OM&A capitalization, and

59.2.3. Any amount of the London Lines Project that is approved by the Board should be allocated in the same manner as the existing assets, and any change to that allocation should only be considered by the OEB during the next rebasing, and in the context of a proper cost allocation study.

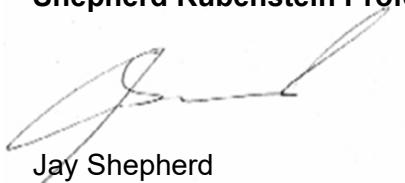
³⁸ Not to mention the fact that it had already been disclosed in the LTC application, so it was clearly not a secret.

60. SEC submits that it has participated responsibly in this proceeding with a view to maximizing its assistance to the Board, and requests that the OEB order reimbursement of SEC's reasonably incurred costs for that participation.

All of which is respectfully submitted.

Yours very truly,

Shepherd Rubenstein Professional Corporation



Jay Shepherd

cc: Wayne McNally, SEC (by email)
Interested Parties (by email)